Company Act

Discussion Paper

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Foreword

The British Columbia *Company Act* was last revised in a major way in 1973. During the intervening period, there have been a number of developments in corporate law in Canada, the United States and elsewhere. These developments, and the last 15 years of experience, require another review of this important legislation.

The purpose of this discussion paper is to begin the public consultation process on major revisions to the *Company Act*. The paper is intended to be a relatively high-level discussion of the policy issues involved as opposed to a section-by-section discussion of the current act. As a result, numerous deficiencies in the current act or areas where improvement is possible through improved drafting, but where the policy intention of the legislation is not being questioned, have not been discussed.

The intention at this time is to produce a new draft statute based on the proposals in this paper and the results of the consultation process for release in 1991. Final legislation could then be introduced in the following session of the Legislature. That is a fairly ambitious schedule, but it is important that British Columbia's company legislation be updated to facilitate business and development within the province.

This paper represents the policy proposals and intentions of the Ministry of Finance and Corporate Relations. In developing these proposals, the ministry is very grateful for the extensive assistance, advice and creativity provided by a committee of lawyers who practise in corporate law, chaired by Mr. John Lundell. That committee has devoted many hours to this initiative over the past year and this paper has benefitted immeasurably from their advice. Responsibility for any errors and for the policy proposals remain with the Ministry of Finance and Corporate Relations.

Comments and suggestions are welcome and will be received at any time. However, in order to have the greatest chance of influencing the final product, comments would be appreciated by March 31, 1991. Comments can be directed to:

Mr. Steve Hollett
Assistant Deputy Minister
Economics and Policy Division
Ministry of Finance and Corporate Relations
Room 109, 617 Government Street
Victoria, British Columbia
V8V 1X4

Chapter 1 — General Issues

Objectives of the Company Act

Various suggestions have been made that corporate statutes should be amended to better reflect broader social goals. Corporations are important economic entities and wield considerable power in society. Some believe that corporate statutes should harness this power and regulate corporations to reflect public interests, rather than the interests of the corporation.

All Canadian jurisdictions have rejected this argument. The aim of corporate statutes in Canada is to provide a vehicle within which business can be carried on for profit in a fair and efficient manner. This objective is well expressed in the following passage, which was also quoted and supported in "Proposals for a New Business Corporation Law for Canada":

> The primary purpose of corporation law is not regulatory. They are enabling acts to authorize businessmen to organize and to operate their business, large or small, with the advantages of the corporate mechanism .... They provide the legal frame and the financial structure of the intricate corporate device by which business can be carried on and in which the combined energies and the capital of the managers and of many investors may work together .... Some of these provisions [in corporate law statutes] are regulatory, seeking to prevent abuses of management and also of the majority, and to protect minority shareholders and creditors. (H.W. Ballantine, *Ballantine on Corporations*, Callaghan and Company, Chicago, 1946, page 41-42.)

The amendments proposed in this discussion paper reflect this view of the purpose of the *Company Act*. The amendments are designed to allow a company to be governed as effectively as possible. Broader social goals, such as the protection of the environment or the regulation of financial institutions, are left to specific statutes.

In general, the changes proposed in this paper seek to improve corporate efficiency by increasing flexibility. If the purpose of the *Company Act* is to provide a structure for doing business with a view to profit then directors, officers and shareholders (which the *Company Act* refers to as "members") should be allowed to manage the company with as little interference as possible. Those who manage or invest in the company have the strongest motivation to try to operate efficiently. Statutory

constraints restrict the ability of a company to adapt to changing circumstances and also impose costs on the company and the economy. These costs can take the form of actual expenditures required to comply with the rules and the cost imposed by being prevented from taking advantage of profitable opportunities.

The policy underlying the proposals in this paper is not to impose restrictions on companies, unless necessary to protect members and persons doing business with companies from having their reasonable expectations frustrated or from otherwise being treated unfairly. An attempt has been made to minimize the costs associated with such regulation.

The objective is to have a *Company Act* which provides a flexible and certain framework for corporate governance under which the interests of various parties are appropriately balanced. It is hoped that, as a result of these changes, companies will be attracted to British Columbia by state-of-the-art legislation which provides an alternative model of incorporation not found in other Canadian jurisdictions. It is also the intention to make it easier for companies to do business in British Columbia, thus enhancing the provincial economy.

Theory of Incorporation

Recent amendments to company statutes in Canada have established two methods of incorporation: the memorandum model and the *Canada Business Corporations Act* registration model.

The registration model allows incorporation as a matter of right upon filing the required documents. This model provides what amounts to a statutory division of powers among directors, shareholders and officers. The division of power can be clarified or modified by internal by-laws, but only in very restricted circumstances can the fundamental division of power be changed completely (unanimous shareholders' agreement).

The memorandum model also allows incorporation as a matter of right upon filing a corporate charter, which is a contract among the shareholders (members) and between each member and the company. Presently, a memorandum and a set of articles must be filed, although the proposals in this paper would require that only a memorandum be filed in order to

incorporate a company. However, the memorandum model does not entail the adoption of a particular statutory structure or division of authority. This model provides a company with greater latitude to determine its own organization within legislated parameters.

Eight of the eleven Canadian jurisdictions have adopted the registration model in their business corporation statutes. British Columbia, however, expressly refused in 1971 to adopt the incorporation by registration method. The authors of the "Departmental Report on the British Columbia Companies Act" noted:

> Uniformity, while a desirable objective, is not paramount. While we have found some very useful and attractive concepts in the Ontario *Business Corporations Act* and the Proposals for a New Business Corporations Law for Canada, they are both adaptations of a letter patent concept which we basically cannot recommend for British Columbia. (*The Companies Act*, Departmental Study Report of the Department of the Attorney-General of British Columbia, December 21, 1971, page 7.)

Despite the widespread adoption of the registration method, the British Columbia position on this issue has not changed. The policy proposed for the British Columbia *Company Act* by this paper is to allow companies the greatest possible flexibility. Companies should be free to establish their own internal organization, subject to some broad restraints. Incorporators should, as a matter of contract, be able to choose the fundamental characteristics of the company that fit their particular needs. The memorandum model better reflects this policy as it is based on the concept of a business entity governed by a contract among its members.

As there is, at present, no restriction on a company incorporated in any province from doing business anywhere in the country, providing an alternative method of incorporation in at least one province may be beneficial. It is proposed that a number of concepts from other business corporation legislation be adopted in British Columbia. For at least one issue (negotiability of share certificates), uniform provisions are being proposed. Within this context, the goal is to produce a unique statute which adopts and improves upon the best provisions in other jurisdictions within the context of the contractarian model of incorporation.

It is proposed that companies in British Columbia continue to be incorporated with a memorandum and articles, which will continue to be contracts among members.

Scope of the Act

The purpose of the *Company Act* is to provide a framework within which a legal person can be incorporated for the purpose of carrying on business with the intention of making a profit. This framework separates the company, which undertakes the business and is ultimately liable for its action and the investors or members, whose liability for the company's actions is generally limited to the investment in the company.

There are other types of incorporated and unincorporated legal persons to which the *Company Act* does not, and should not, apply. The *Company Act* should not apply to corporate entities which do not operate for profit. Charities, societies and other not-for-profit entities are fundamentally different from companies. Cooperative associations, while many are profit motivated business corporations, also differ fundamentally from companies in principle and are governed by their own statute. Furthermore, the act should apply only to companies. The mechanisms and safeguards outlined in the act are inappropriate to partnerships, sole proprietorships and other non-corporate forms of organizing a business.

The primary focus of the act is the creation and governance of business corporations where a member's influence is, in general, based on the member's relative investment. The manner in which shares and other securities of the widely-held company are issued and traded is the jurisdiction of the *Securities Act*. Unfortunately, the distinction between matters that should be governed by the *Company Act* and the *Securities Act* is sometimes difficult to draw. The present *Company Act* acknowledges that companies whose shares are widely traded or held — "reporting companies" — should be governed differently than other companies. For example, special provisions exist for the financial records, auditing and meetings of reporting companies.

However, the securities legislation or policy also covers some of these areas. Many of the provisions of the two statutes no longer mesh. Companies are sometimes hard-pressed to comply with both statutes at the same time.

It is proposed that the *Company Act* be amended to make it more consistent with securities legislation and policy. Issues also addressed in securities legislation and policy would no longer be addressed by the *Company Act*. The basic principle is that the *Company Act* will provide the corporate law structure for all companies and the *Securities Act* will provide the special provisions required for securities regulation.

This issue is discussed further in chapter 7 — Types of Companies.

Disclosure

The public requires certain information about a company before the public can confidently deal with the company. A corporation may have various restrictions on its ability to deal with the public which do not exist for individuals. As the *Company Act* is self-regulating, members of the public must inform themselves about these restrictions and take steps to protect themselves.

Furthermore, the self-regulating nature of the act requires members to protect their own interests. Allowing them access to corporate information ensures that members have the ability to protect their own interests. There must be easy, reliable disclosure of relevant corporate information if companies are to function smoothly.

On the other hand, requirements to file documents are often time-consuming and expensive. The need to file documents at either the Corporate Registry or the records office of the company, and sometimes at both, adds to the expense of carrying on business. Requiring disclosure of too much information may also adversely affect the competitive position of a company. Competitors of the company may use information to gain an unfair advantage.

The proposals contained in this paper attempt to balance these two considerations by streamlining the disclosure requirements in the current act. In general, companies should only have to file documents at the Corporate Registry which might be necessary to a third party dealing with the company. The public will need the information filed at the registry in order to reach an informed decision when dealing with the company.

Documents filed at the records office of the company should contain the information related to the internal governance of the company needed by members to ensure it is being properly managed.

The disclosure of information related to investing in a widely-held company — as opposed to the operation and governance of a company — will not be governed by the *Company Act*. As discussed above, the *Company Act* is concerned with the operation and governance of business corporations. In general, information relating to investing in a company is properly governed by the *Securities Act*.

Role of the Court and the Registrar

A primary principle of the act is that a company should be governed by the persons most knowledgeable about its affairs — its own members, directors and officers. The *Company Act* is not a regulatory statute and companies should largely be self-governing. Requiring corporate decisions to be approved by outside parties (such as the court or the Registrar of Companies [Registrar]) is often unnecessarily expensive. Even if the application is routine, requiring the approval of an outside party adds to the uncertainty of governing the corporation.

For these reasons, the proposed amendments avoid, wherever possible, applications to the court or to the Registrar to approve corporate procedure. Alternate procedures are proposed for routine applications that are currently made to the court or to the Registrar.

Nonetheless, there are circumstances where either the court or the Registrar should intervene in the internal affairs of the company. If companies are to be given flexibility in their management, then steps must be taken to ensure that the flexibility is not abused. Intervention from the court or the Registrar will be necessary, in certain circumstances, to ensure that all parties are treated fairly.

The proposals suggest that the roles of the court and the Registrar in regulating companies should be more clearly defined and consistently applied than at present. The court should act as a remedial and adjudicative body, and not as a regulator of industry as it now sometimes does. Outside of winding-up companies, the proposals in this paper suggest that the court should have three principal functions:

- imposing penalties for breach of the *Company Act*;
- granting remedies to dissenting minority members and others; and
- determining civil claims for breach of the *Company Act*, or the company's internal by-laws.

The Registrar's primary role is to maintain the integrity of the registry. To some extent, the current act also casts the Registrar in the role of arbiter of legal questions regarding whether or not certain actions or documents comply with the act. The proposals in this paper suggest that role be down-played, relying on companies and their legal advisors to interpret the legislation, subject to the need to have an accurate and up-to-date Corporate Registry.

New Developments

A number of developments have taken place since the last major revision of the British Columbia *Company Act*. New technology now permits more convenient methods of storing data, recording transactions and searching records.

The *Company Act* must be updated to take into account these changes. British Columbia companies should be able to take advantage of efficiencies offered by these developments. The increase in use of negotiable share certificates, restricted shares and other financial instruments are dealt with in this paper. As well, technological advances, such as computer-based share clearing systems, remote registration and data systems are dealt with.

Business Names

Corporate names is one area in which the regulation of companies should be consistent and integrated with the regulation of other types of businesses. The public has an interest in ensuring that names of companies, societies, associations and other corporations, as well as the names of unincorporated businesses, are assigned and protected in a clear and certain fashion.

Creditors, purchasers and other members of the public must be able to identify, with certainty, a business. It is more difficult to carry on business if business names are not distinctive.

It is in the interest of companies to have the names of all businesses regulated. Companies usually carry on business under their company names, and company names will acquire value as goodwill attaches to them. Goodwill can also attach to another name under which a company does business and which it may want to protect.

Persons about to form a company should be able to know that the name they have chosen for their company will not be confused with the name of an existing business. Conversely, companies that already exist should know that a new company or business will not be formed with a name that is very similar to their own.

The current provisions dealing with company names do not interact well with other provisions relating to names of businesses in this province. Under the existing statutory law, a company may be registered under the same name as an existing, unincorporated business. On the other hand, the name of a proprietorship or partnership will not be registered under the *Partnership Act* if it can be confused with an existing company name.

The present law does little to prevent conflicts regarding proprietary interests in a business name. The legislation is clear that registration of a corporate name does not provide a proprietary interest in that name, and the corporation may be liable under the federal *Trademark Act* or common law passing off actions. However, it is often difficult for a person wishing to incorporate a company to discover if the proposed name is already being used by an unincorporated business or if a company is carrying on business under a similar name.

The present law makes it difficult for an extraprovincial corporation with an unacceptable name to carry on business in British Columbia.

It is proposed that a new *Business Names Act* be established in British Columbia. This statute would regulate the names of all business entities and other organizations in British Columbia. It would prevent any entity — be it a corporation, proprietorship, partnership or other organization — from having or using a misleading or confusing name, including a name which conflicts with another name registered under the act. This will provide more information and protection to incorporators, and help prevent conflicting claims to a property interest in a business name. As discussed in

chapter 10, special provisions will exist for extraprovincial companies whose names conflict with names of existing British Columbia businesses or corporations.

As a transitional provision, it is proposed that the legislation not apply to names in use prior to the legislation coming into force for a period of time (two years is proposed). After that time, if the name has not been registered, it would lose any protection. Where two existing names are identical or very similar, it would be possible to register both, without either name receiving priority or advantage over the other under the act. That would not, however, affect the application of trademark legislation or the common law.

Consideration will also be given to requiring a NUANS search and to precluding registrations which conflict with a name registered under the NUANS system.

Transition

The proposals contained in this paper will impact existing companies to some extent. That means that provisions will have to be included to deal with the transition issue. There are a number of different models which could be adopted, including:

- requiring all companies to effectively re-incorporate, filing new memoranda under the new act within a given time period, say three years. Under this model, the old provisions would apply to the company until it has re-filed. Any companies not re-filing within the required time period would be effectively struck off the register;
- deeming the new provisions to apply to every company (this would effectively, by statute, change the contract between the members and the company); and
- determining transition provisions for each suggested change, on a case-by-case basis.

The first model is quite extreme and is only required where there are fundamental changes to the structure of the act. The changes proposed in this paper, while important and wide-ranging are, in principle, consistent with the existing legislation. The first model is not being proposed.

It is also unlikely that many of the proposed changes need to be imposed through effectively amending, by statute, existing

contracts and corporate charters. Most changes which affect charters provide options for greater flexibility which can be adopted, or not, at the discretion of the members.

It is proposed that transition be handled on a case-by-case basis in such a way as to minimize the expense and disruption caused by the changes, consistent with achieving the objectives of the proposals.

There are a significant number of corporations in British Columbia created by special acts, many of which adopt some or all of the *Company Act* by reference. The transitional problems associated with these special act corporations are more difficult. The options seem to be:

- consequentially amend all special acts to correct references to the *Company Act*;
- deal with the principals of special act companies on a case-by-case basis to determine what consequential amendments are appropriate; or
- include a provision in the legislation to the effect that the old *Company Act* will remain in force for the purpose of references in statutes creating special act corporations. Any special act corporations wishing to take advantage of the new act would then be able to convert to a company or seek to have their act changed to specifically adopt some or all of the new act.

It is proposed that the third option be adopted.

Chapter 2 — Incorporation

Pre-Incorporation Contracts

Contracts are sometimes made in the name of, or on behalf of, companies which do not yet exist. These contracts are referred to as "pre-incorporation contracts."

Pre-incorporation contracts in British Columbia are governed by the common law. Under the common law, a company cannot adopt a pre-incorporation contract so as to be liable under it. The person who entered into a contract on behalf of the company (the promoter) may be personally liable under the contract depending upon the form of his signature. Alternatively, the promoter may be liable in an action for breach of warranty or deceit.

This situation is unsatisfactory. Companies should have the flexibility to adopt a pre-incorporation contract if the directors decide it is in the best interest of the company. The public should also have some protection when contracting with promoters. As one writer has noted:

> The common law does not provide adequate tools for the equitable allocation of liabilities and rights arising under pre-incorporation contracts. Even though it is possible for contracting parties to circumvent the pitfalls of the case law by obtaining personal undertakings from the promoter, these pitfalls still present an unnecessary trap for unsophisticated people. (Frank Iacobucci, et al., *Canadian Business Corporations: An Analysis of Recent Legislative Developments*, Canadian Law Book Limited, Ontario, 1977, page 52.)

Two principal methods have been adopted in Canada for dealing with pre-incorporation contracts. In the *Ontario Business Corporations Act* and the *Canada Business Corporations Act*, the promoter is personally responsible for the contract. Personal responsibility for the contract ends if the company adopts the contract within a reasonable length of time. The *Alberta Business Corporations Act*, on the other hand, deems the promoter to warrant to the other party that the contract will be adopted.

The federal and Ontario solution imposes a contract that, in the usual case, will be contrary to the intention of the parties. The promoter did not wish to personally enter into a contract at all. The third party wished to enter into a contract with the

company, and may not wish to enter into a contract with an individual. The Alberta solution more accurately captures what the parties likely intend when entering a pre-incorporation contract. In most cases, the third party believes that the company already exists, or will adopt the contract when it is created. The promoter, whose actions induced these beliefs, should be deemed to warrant the accuracy of these facts.

Allowing companies the option of adopting contracts may result in unfairness. For example, a company may have significant assets and have benefitted from the contract, but may refuse to adopt it. The promoter may be responsible for the contract, but may not have any assets. In these and other circumstances, the court should be allowed to apportion liability for the contract among the various parties.

It is proposed that pre-incorporation contracts be specifically dealt with in the act, including the following provisions:

- "pre-incorporation contracts" would be defined to include any oral or written agreement which purports to be a contract made by a company before the company comes into existence;
- companies would be allowed to adopt such contracts either expressly, or by implication. No criteria would be set out for determining when a contract is adopted by a company, to allow for greater flexibility;
- promoters would be deemed to warrant the incorporation of the company and the adoption of contracts by the company within a reasonable length of time;
- any party to the purported contract would be able to apply to court to re-apportion liability for the contract; and
- the British Columbia act would apply to a pre-incorporation contract entered into in British Columbia unless one of the parties can prove that when the contract was entered into, the intention was to incorporate the company under another business corporation statute.

No transition provisions are proposed for these changes.

The current act requires a person incorporating a company to file the memorandum, articles and notice of offices with the Registrar. The memorandum currently contains the corporate name, the authorized capital and any restrictions on businesses or powers of the company. The articles of a company generally contain the internal by-laws governing the company, as well as some provisions relating to the company's dealings with third parties, such as borrowing restrictions.

Requiring companies to file the company articles at the registry office increases the costs to all parties. Incorporators face considerable delay in having their articles filed, and the government incurs considerable storage costs. The reason for filing documents with the Registrar is to provide the public with access to information which it needs when dealing with a company.

However, it can be argued that protection of the public need not suffer if the Registrar is no longer required to maintain records of company articles. The act already abolishes the doctrine of constructive notice. That, in addition to the proposal to add a statutory indoor management rule (see chapter 6), means that the internal by-laws governing the company should not affect a person dealing with the company in the normal course of business. Information often included in articles which is important to the public, such as the existence of special rights or restrictions on shares, could be required to be in the memorandum. The number of times an unrelated member of the public would really need to see the articles would be quite small (e.g. in the case of a proposed takeover bid). In that case, the person, or a representative, would be able to check the articles of the company at its records office.

The cost to companies and to the government of filing articles may outweigh the value in having them centrally available. However, if articles are no longer filed in the registry, it will be even more important that access to information at the company's records office be unimpeded. This issue is discussed in chapter 8.

It is proposed that the memorandum of a company continue to be filed, but not the articles. The information required to be in a memorandum would be expanded to include information that would be important to a member of the public:

- the existence (but not the content of) special rights and restrictions attached to any class of shares, with separate disclosure of the existence of restrictions on the transfer of shares, if any;

- if shares in a class are issued in series, the ability of the directors to set the number, rights and restrictions of shares issued in each series; and

- the elimination of pre-emptive rights on the issue of shares (if the proposal in chapter 5 to make pre-emptive rights optional is adopted).

As a transition provision for companies which do not provide this information in their memorandum, it is proposed that a form be required to be filed setting out the relevant information. Failure to file the form would be treated the same way as failure to file an annual report. After two years (at which time those not in compliance could be struck off), the Registrar would be authorized to destroy filed articles.

Incorporators

The current act allows one or more natural persons to incorporate a company. A corporation cannot incorporate, on its own behalf, another company. This often leads to the fiction of having stenographers or articling students incorporate companies. Preventing corporations from incorporating companies does not serve any public protection purpose. A corporation should be given the option of incorporating a company, as most corporations already have all of the other powers and capacity of a natural person.

It is proposed that corporations, as well as natural persons, be able to incorporate a company.

No transition provision is required.

Chapter 3 — Directors and Officers

Duties and Powers

Section 141 gives directors the power to manage a company subject to the act and the articles of the company. This provision is in marked contrast to several other business corporation acts. The *Ontario Business Corporations Act* requires the directors to manage the corporation without making any reference to the by-laws of the company. The shareholders have no right to restrict the management powers of the directors, although shareholders may participate in management decisions and call directors to account for mismanagement and abuse of power. The Alberta and federal statutes are similar. All these statutes allow unanimous shareholder agreements to vary the power and responsibility of directors.

Section 141 is consistent with the underlying principle that the internal governance of a company should be a matter of contract among the members. The incorporators should be able to allocate responsibility and authority between the members and the directors.

Allowing the powers and responsibilities of the directors to be altered by a unanimous shareholders' agreement fills a similar role but does not provide as much flexibility as the current British Columbia provision. Chapter 5 discusses the issue of the majority required to pass a special resolution. A special resolution is needed to amend the articles. One of the reasons this approach to special resolutions is being proposed is to address the issue of member control in a flexible and consistent manner.

It is proposed that the current arrangement be continued, allowing the authority and responsibilities of directors and members to be set by the articles and that "unanimous shareholder agreement" provisions not be adopted.

No transition provision is required.

Conflict of Interest

Sections 144 to 147 of the *Company Act* regulate both the conduct of directors and the ratification of contracts involving a conflict of interest. A director must disclose any interest in most contracts to the other directors. The director may keep the profits of the contract if the other directors approve.

Alternatively, if the contract is reasonable and fair to the company and the director has obtained a special resolution from the members approving the contract, the director will not be held liable. If the contract is not properly approved or, in the case of a contract approved by the members, is not fair and reasonable, a court may block or rescind the contract.

These sections attempt to balance flexibility of management with the protection of members with a minority interest. The provisions are intended to permit directors, with the appropriate approval, to enter into contracts which benefit both themselves and the company. The members are protected by having these contracts scrutinized by either the other directors or by themselves.

In broad terms, sections 144 to 147 codify the normal ethics of modern business. Businessmen should expect that they are required to inform the other directors of any conflict of interest and seek the directors' approval. Similar provisions have been adopted by other company law statutes in Canada, including the *Alberta Business Corporations Act*, the *Ontario Business Corporations Act* and the *Canada Business Corporations Act*. These provisions are based on similar sections of the New York and California corporate law statutes.

There are two significant problems with the current British Columbia provisions. First, the British Columbia provisions require directors to disclose all proposed contracts or transactions in which they have an interest, no matter how trivial the interest or the contract; but there is no requirement to disclose previous conflicts. Other Canadian business corporation statutes require that directors disclose only material interests in material contracts. Directors in other jurisdictions must reveal these interests not only in proposed contracts, but also in existing contracts. Partly as a result of this problem, the British Columbia provision is often not complied with.

Requiring directors to disclose only material interests in material contracts would improve the practical application of this provision. Disclosing contracts and interests which are not material does not protect companies. Immaterial contracts should not be rescinded because of an innocent oversight on the part of an interested director. If there are doubts as to whether an interest or contract is material, then the director should disclose.

Requiring directors to disclose material interests in existing contracts, as well as proposed contracts, would improve this section. Even though the interested director was not a director at the time the contract was entered into, or did not have an interest in the contract when approved, the director may have a role in maintaining or renewing the contract. The other directors should be able to judge the opinions of the interested director in light of the conflict of interest.

The second problem is that the method of ratifying a contract in which a director is interested and the remedies do not fully achieve their objectives. Section 145 of the British Columbia *Company Act* allows a contract to be ratified by the board of directors without the members ever receiving notice of the conflict or having access to records in which the conflict is revealed. (Members do not have access to minutes of directors' meetings.) This provision raises the possibility of directors acting for their own mutual interest rather than the interests of the members. As Professor Gower has noted:

> It hardly seems over-cynical to suggest that disclosure to one's cronies is a less effective restraint on self-seeking than disclosure to those for whom one is a fiduciary. (L.C.B. Gower, *The Principles of Modern Company Law*, 3rd edition, Stevens and Sons, London, 1969, page 530.)

The Ontario, Alberta and federal statutes require that when the board of directors approve such contracts, the contract must meet a test of reasonableness or fairness. The British Columbia act only applies the reasonable and fair test to contracts approved by the members; not those approved by the directors.

If a court finds that a contract is not fair and reasonable, it can void the contract even if the contract has been duly approved by the directors or members. While there does not seem to be much justification for only applying the fair and reasonable test to contracts approved by the members, there is an argument against following the other statutes mentioned above. The uncertainty created by the fact that a contract duly approved may be overturned by the court is a serious drawback. The intention of the test is clearly to ensure that those approving the contract understand their duties to the company. However, that duty is already clear in respect of directors, and the members' interest should be consistent with the interests of the company in these circumstances. Remedies already exist against directors who improperly approve such

contracts, and oppression remedies exist if minority members are oppressed by an approval.

In the interests of certainty for innocent third parties involved in contracts where there is a conflict of interest, such contracts should stand if duly approved, even if the approval was inappropriate. Those who improperly approve should bear the burden; not innocent third parties. On the other hand, where there is a conflict which is not disclosed and the contract is not duly approved, the court should have broad discretion to deal with the matter, including the power to void the contract. Even in these circumstances, consideration should specifically be given to any innocent third parties who might be affected.

It is proposed that the conflict of interest provisions be amended to:

- require directors to disclose interests material to the director in contracts material to the company, whether the contract is in existence when the director is appointed or is proposed subsequently. A newly appointed director with an interest in an existing contract or a director who becomes interested in a contract after it is entered into, would have to disclose the interest at the first opportunity. For existing directors with interests in contracts which have not been disclosed at the time the amendment comes into force, it is proposed that the disclosure be required at the first opportunity after the amendment comes into force;

- require directors to reveal, in writing, conflicts involving material interests in material contracts to the other directors. A copy of the written notice would be filed at the company records office; and

- change the ratification and remedy provisions so that the directors or, alternatively, the members would have to approve a proposed contract for the director not to be liable to the company for profits generated by the contract. Existing contracts in which a new director has an interest would not need to be ratified. The director with the conflict of interest would be precluded from voting to approve the contract. The court would no longer have power to set aside a contract once approved by either the members or the directors. However, the members of the company would continue to have

remedies against the directors who approved the contract, or the members who voted against the contract would continue to have remedies against the company in cases of oppression.

The court would be able to set aside a contract involving a conflict of interest if it has not been approved by either the directors or the members. However, the court would have to consider the effect of rescinding the contract on third parties before exercising this discretion.

No transition provision is required.

Officers

Section 157 requires every company to have a president and a secretary, and permits the articles to provide for other officers. The president of the company is required to be a director of the company. The act also specifies some of the duties of the secretary, including keeping records and making the required filings.

This section appears to be an unwarranted intrusion into the management of a company. The members of the company should be able to decide not only how the company should be run, but also who is to run it. The requirement that the president of a company be a director does not seem to protect either the public or the members. Furthermore, there does not appear to be any reason why a separate office of secretary, or even president, is mandatory, so long as rules for service on the company do not specify that the secretary must be served. There are no statutory duties now imposed on the president.

It is proposed that either the articles or the directors be permitted to create officers of the company and establish their duties. None of the officers would need to be directors. Furthermore, the act would require the directors to fulfill the duties currently imposed on the secretary, but would allow the directors to delegate this duty. Having a secretary and/or president would not be mandatory.

No transition provision is required.

List of Officers in Annual Report

The current act requires the annual report of the company to include a list of all officers. However, "officer" is not defined, so it is unclear exactly how far a company must go to satisfy this requirement. In addition, there is no requirement to file a notice of appointment or cessation of officers. As a result, the information filed in the annual report cannot be relied upon as current, except at the time of filing.

It is not clear that any policy purpose is achieved by this requirement as it now stands. Presumably, the objective is to provide information to potential litigants. That objective is not achieved. The alternatives seem to be to require notices of appointment or notices of cessation of officers to be filed in the corporate registry or to remove officers from the annual report and have some record of officers (i.e., only "senior officers" as defined in the act) in the records office.

It is proposed that the requirement to list officers in the annual report be deleted, but that up-to-date records of senior officers be maintained in the records office.

No transition provision is required.

Residency Requirement

Section 133 of the act requires a majority of the directors to be residents of Canada, and at least one director must be a resident of British Columbia. In contrast, some business corporation statutes in Canada have abandoned the requirement that a director reside in the jurisdiction.

Requiring that at least one director reside in British Columbia and the majority of directors reside in Canada may help ensure that companies registered in this province are aware of local sensitivities. However, this requirement interferes with a company's right to choose to whom the management of the company should be entrusted. It often leads to token or "dummy" directors being chosen to fulfill the residency requirement. The residency requirement may also force companies to incorporate in other provinces that do not have the residency requirement.

It is proposed that the residency requirements for directors be deleted.

No transition provision is required.

Subscribers

Section 134 of the current act provides that the subscribers to the memorandum are the first directors of the company. Other business corporation acts, notably the *Ontario Business Corporations Act* and the *Canada Business Corporations Act*, do not contain such a provision.

There may be circumstances where the subscribers do not wish to be the directors of the company and there is no public policy reason to require it. The subscribers should be able to decide who should be the directors of the company, subject only to the directors consenting to serve. The requirement is also inconsistent with allowing corporations to incorporate companies (see chapter 2).

It is proposed that the first directors of a company be named in an appendix to the memorandum. The first directors would not need to be subscribers to the memorandum but their prior consent to be directors would be required.

No transition provision is required.

Alternate Directors

The current law in British Columbia is unclear on the effectiveness of a person appointed to the board of directors as an alternate director. The current act is silent as to the role of alternate directors, the validity of their actions or how long an alternate director may sit in place of an elected director. The common law is also unclear on this point, and the effectiveness of alternate directors is open to doubt.

Alternate directors are often necessary for the efficient management of a company. It may be necessary for the board of directors of a company to pass a resolution while a quorum can not be achieved because of the absence of one or more directors. Unless the act clarifies the effect of a resolution passed by a board which includes an alternate director, the validity of such resolutions will be open to question.

On the other hand, alternate directors may interfere with members' rights. Unlike an ordinary director, alternate directors are not elected by the members but are appointed by existing directors. An alternate director may not represent the interests of the members that voted for the original director.

A further danger with alternate directors is that their appointment could be used as a way of avoiding responsibility

for difficult or controversial decisions. One method for avoiding this problem would be to deem the original director responsible for the actions of the alternate. This solution would encourage directors to be careful in choosing their alternates. On the other hand, it would discourage the use of alternates, as the original director would be responsible for acts he had no control over. It would also expose the original director to risks he could not anticipate. On balance, it is not proposed to make directors responsible for the actions of their alternate.

It is proposed to clarify that the articles of a company may provide for the appointment of alternate directors. A resolution voted on with an alternate director would have the same effort as a resolution voted on by original directors. Furthermore, members would have to be informed of how often an alternate was used by a director seeking re-election to the board of directors.

No transition provision is proposed, other than to clarify that these provisions are not intended to call into question the actions of alternate directors prior to the changes becoming effective.

Director and Officer Indemnification

Indemnification of directors and officers is one of the most complex and important areas covered by company legislation. It is important that the appropriate balance be achieved between ensuring that directors and officers fulfill their duties and responsibilities and assuring directors and officers they will not suffer financially, so long as they fulfill those duties and responsibilities.

At common law, directors and officers are not only agents of the company for which they act but are, to some extent, in a fiduciary relationship with respect to the company's property and assets under their control. As such, there are a number of fiduciary duties imposed on directors which have been developed and elaborated in the case law, including the duty to act honestly, in good faith and in the best interests of the company.

Many of these fiduciary duties have now been codified in corporation statutes. As well, legislatures have increasingly imposed specific duties, prohibitions and liabilities on directors and officers in addition to the general standards developed by the common law. This increase in exposure to

personal liability has made it more difficult to attract competent directors and officers, unless some form of relief from personal liability can be provided.

There are clearly public interest reasons to regulate the circumstances in which a company is permitted to indemnify its directors and officers. For example, if a company was permitted to completely relieve its directors and officers from liability for breach of common law or statutory duties, the high standards of conduct required of directors and officers would be nullified.

Section 152 of the British Columbia act permits a company to indemnify its own directors and officers, former directors and officers and those of another corporation whose shares are held by the company. These people may be indemnified for all expenses reasonably incurred, including amounts paid to settle an action or satisfy a judgment, in a civil, criminal or administrative action or proceeding. Indemnification is only permitted if the person has acted honestly and in good faith with a view to the best interests of the company and, in the case of a criminal or administrative proceeding, the person had reasonable grounds for believing the conduct was lawful. Court approval is required for all indemnities.

It has been pointed out that there are a number of practical problems with this provision. First, court approval is costly to both the company and the court system, particularly where a director or officer was clearly acting on the direction and in the best interests of the company. Most other jurisdictions require court approval only where the action against the director is for, or on behalf of, the company. Court approval is not required in respect of third party actions.

Second, the section arguably does not permit indemnification for costs incurred prior to an action or proceeding being formally commenced. The argument is that by specifying "actions" and "proceedings," the section prohibits indemnification for costs arising during the period leading up to the formal commencement of the action or proceeding. Thus, directors and officers may be compelled to use their personal funds to finance their defense if no formal action arises. This is also a problem with indemnification provisions in most other jurisdictions.

Third, the indemnification provisions are permissive only. Consequently, unless directors or officers have sufficient

knowledge or sophistication to obtain an indemnification agreement from the company prior to accepting office, they might be unable to obtain indemnification from their company even though they are successful in an action and otherwise entitled to indemnification. Most other jurisdictions provide some mandatory indemnification if the director or officer is vindicated.

It is proposed that section 152 be replaced with a comprehensive provision with the following elements:

- To be eligible for indemnification, directors and officers must have acted honestly, in good faith and in the best interests of the company and, in the case of a criminal or administrative proceeding, they must have had reasonable grounds for believing their conduct was lawful.

- In the case of actions taken against directors and officers other than actions for or on behalf of the company, directors and officers could be indemnified for both expenses and the amount of any settlement or judgment without court approval.

- In the case of actions by or on behalf of the company, directors and officers could only be indemnified for expenses, not amounts paid in settlement, and court approval would be required.

- The proposed provisions would apply to all actions, proceedings or investigations, whether civil, criminal or regulatory (administrative) and whether anticipated, threatened, pending, commenced, continuing or completed.

- There would be a provision requiring a company to indemnify a director or officer if the director or officer has met the general fiduciary standards and is successful in the outcome of the proceeding. "Successful" in the context of that portion of the action involving a director, would be defined as wholly successful on any basis or substantially successful on the merits of the case.

- A company would be permitted to reimburse reasonable expenses incurred by directors and officers in advance of the final disposition of a proceeding,

provided there is a written undertaking to repay if the general fiduciary standards are not met.

- The court would be given wide power to take action on the application of any interested person to ensure that indemnities are provided where required, not provided where prohibited and otherwise administered fairly.

No specific transition provision is proposed but, for fairness, it is proposed that the new provision be specifically made to apply to any matter which could give rise to indemnification and which has not been concluded when the provision comes into force.

Draft wording for the proposed indemnification provision is provided in Appendix A.

Non-Voting Shares

Shares that do not allow their owners the right to vote in the affairs of the company (non-voting shares) are implicitly authorized by the current act. Section 185(c) states that every member shall have a vote unless the memorandum otherwise provide. Using this provision, many companies have provided in their memorandum for a class of share that does not have a right to vote. Most, though not all, Canadian corporate statutes have similar provisions.

Non-voting shares may provide the potential for inequities. Individuals holding a small number of voting shares and a small fraction of the equity may effectively control the company. The owners of the voting shares may unfairly take advantage of their position at the expense of non-voting members, who have provided the company with most of its capital.

On the other hand, banning non-voting shares would be an unwarranted interference with the ability of companies to arrange their financing as they and their investors see fit. Non-voting shares have many legitimate uses, including estate planning. If purchasers of non-voting shares are aware of the limitations on the shares the decision to invest in these shares, despite the limitations, should be respected. In addition, oppression remedies (discussed in this chapter) and protections provided by securities law for publicly traded companies offset the potential problems.

The *Company Act* must ensure that the reasonable expectations of non-voting members, as with all other parties dealing with a company, are fulfilled. It is not in the long-run interest of either investors or companies to allow the reasonable expectations of non-voting members to be frustrated. Although a non-voting member could not reasonably expect to share in management decisions, it is a reasonable expectation of every member that the fundamental nature of the company will not change without the member being informed of the change and of the member's right to dissent.

It is proposed that non-voting shares continue to be allowed. However, it is proposed that management of companies be required to inform non-voting members of fundamental alterations of the company, and of their rights to have their shares repurchased by the company pursuant to section 231.

These fundamental changes are: transferring the incorporation of the company from the province (section 37); selling the whole of the undertaking of the company (section 150); altering the restrictions contained in the memorandum of the company (section 245); and selling the company for shares or debentures (section 313). Non-voting members would continue to vote on amalgamations and changes which prejudice or interfere with the rights of their class of shares (section 250).

No transition provision is required.

Class Rights

Sections 248 to 251 deal with changes to rights or special rights or restrictions attached to classes or series of shares of a company. These sections require that members holding shares of each class or series of shares approve, by a $^{3}/_{4}$ majority, a change which prejudices or interferes with their rights. The Superintendent of Brokers must also approve these changes if the company is a reporting company. Furthermore, even if the change is approved, 10 per cent of the affected members may ask the court to block the changes if they voted against it (section 251).

These sections raise two separate problems. The meaning of the phrase "prejudiced or interfered with" in section 250 is uncertain and has required considerable judicial interpretation. Section 250 requires company managers to exercise their judgment as to whether a resolution prejudices a right or special right attached to a class of shares — often a difficult question.

The second issue is that section 251 may give members with a minority interest an unwarranted amount of power. Members representing a small fraction of the company's equity may be able to block the resolution by means of court action without having to show that the resolution is unfair or oppressive.

The protection given to classes of shares should balance the interests of minority members with the ability of a company to manage its affairs with certainty and flexibility. Members should have the right to vote on any change that negatively affects the rights of their class of shares in a material way. Ideally, changes to rights of classes of shares which do not significantly affect other classes should not require the approval of the other classes.

One method of achieving this balance is to require class approval whenever certain rights are going to be changed. In effect, certain changes would be deemed to be prejudicial, and class votes would always be required when these changes are proposed. This method would eliminate the uncertainty, although it would make routine alterations more difficult. This method has been adopted by the *Canada Business Corporations Act* and other business corporation statutes in Canada.

On balance, however, the uncertainty inherent in the current approach seems to be more than offset by the flexibility it affords companies. The current approach allows company managers to proceed quickly with changes that are not prejudicial to class rights. In practice, if managers are unsure whether a change is prejudicial, the change may be ratified by a class vote. The method adopted by the *Canada Business Corporations Act* would require a class vote even where changes are clearly not prejudicial to any class of members.

There are also alternatives to the remedy set out in section 251. In the *Canada Business Corporations Act*, a shareholder who dissents from the resolution affecting his class rights is entitled to have his shares purchased by the company. Another alternative would be to provide a remedy only if the resolution affecting the class of shares is "unfairly prejudicial" pursuant to section 224.

A member of a company whose interest in the company is prejudiced by a resolution under section 250 may bring an action under the oppression remedies of section 224. It is not proposed to give dissent rights to class members who vote against the resolution.

It is proposed that resolutions that prejudice or interfere with the rights or special rights of a class or series of shares require approval by a $^{2}/_{3}$ majority of votes cast (or whatever majority is required for a special resolution). The Superintendent of Brokers' approval would also be required in the case of reporting issuers. The remedy contained in section 251 would be eliminated.

No transition provision is required.

Oppression Remedies

Section 224 of the act provides members with a method of obtaining relief if the company is managed in an oppressive or unfairly prejudicial manner. This section can be the source of some uncertainty and it explicitly allows the court to interfere with the affairs of a company. However, it ensures that parties investing in a company may do so knowing that minimal standards of fairness will be enforced. The section recognizes that unscrupulous parties may abuse the flexibility contained in the act, and that it is impossible to legislate against all such circumstances. For these reasons, provisions similar to section 224 have been adopted in the United Kingdom and other corporate law statutes in Canada.

The present wording of section 224(6) allows beneficial owners of shares access to the oppression remedy, but requires any other person to first convince a court that they are a "proper person to make an application under this section." This creates unnecessary uncertainty in the application of the provision. Expanding the definition of parties who can commence an oppression remedy without the need for a court to exercise its discretion would improve this section.

It is proposed that the category of parties who can apply for relief under section 224 be expanded to include past members, current and past directors as well as other parties that the court, in its discretion, allows.

No transition provision is required.

Derivative Actions

Section 225 provides that a member or director may, with the leave of the court and subject to certain conditions, initiate or defend an action in the name, or on behalf of, a company. This provision is needed because the common law methods of intervening in actions involving companies are unsatisfactory. Other jurisdictions have similar provisions.

There are a number of problems with this provision. First, access to the remedy may be too narrow. Section 225 allows a member to commence an action with leave of the court only if the person was a member of the company at the time of the transaction or other event giving rise to the cause of action. However, other parties, such as members who purchased their shares after the event, should also be able to take advantage of this section.

Second, any judgment must be paid to the company — rather than the members bringing the derivative action — if the derivative action is successful. This may result in parties who have engaged in misconduct sharing in the recovery.

Third, there is no provision allowing the court to require that security for costs be posted. Security for costs may be necessary in some cases, given that the nature of derivative actions is that one party is bringing or defending an action on behalf of another.

Finally, section 225 may not be exclusive. That is, it may still be possible for other parties to bring applications under the common law following cases such as *Foss v. Harbottle*. The difficulties of bringing a derivative action under the common law are so serious that this concern is likely to be purely academic. Nevertheless, parties who do not meet the criteria set out in section 225 should not be allowed to bring a derivative action. Derivative actions are intrusions in the authority of corporate managers to manage the affairs of the company. The intent is to ensure these intrusions occur only when justified.

The flexibility of the *Company Act* must be balanced with remedies which discourage abuse. As with the oppression remedy, the provisions regarding derivative actions must be broad enough to handle the nearly infinite variety of situations that may arise. The court should be able to permit applications from other parties besides directors and members. The requirement to be a member at the time a derivative action is undertaken, although common in American statutes, is not relevant in a Canadian context (see Iacobucci, footnote 254, page 198). Furthermore, the court should be able to direct payment of the judgment and security for costs to take into account any special circumstances. However, the statutory provision should clearly replace any common law remedy.

It is proposed that the court be given discretion to allow past directors and members to bring a derivative action. The court would also have the ability to direct the payment of any judgment resulting from the derivative action, and to require that an applicant post security for costs. It is also proposed that the derivative actions provision be drafted so as to preclude derivative actions under the common law.

No transition provision is required.

Sections 233 to 239 allow either a member, a company or the minister to apply to the court for the appointment of an inspector to investigate the affairs of the company.

The appointment of an inspector, at the request of a party with a legitimate interest in the affairs of a company, is an effective remedy. The possibility of an inspector being appointed may be enough to prevent a manager from abusing authority without the need for intervention in the internal affairs of the company.

On the other hand, it is necessary to restrict the right to apply for an investigation to ensure that this right is not abused. As one textbook notes:

> The negative aspect of the right to an investigation is that it might be abused, especially as a method of harassing corporate management. The threat or initiation of an investigation, if not properly restricted, could be used as a tool in effect to blackmail management, as an investigation is certain to be time-consuming and inconvenient and may generate bad publicity. (Iacobucci, page 215.)

The right of interested parties to apply for an investigation must be balanced against the danger of investigations being abused.

In the context of the principles underlying the proposals in this paper, sections 233 to 239 no longer provide this balance. The ability of the minister to apply for the appointment of an inspector is a regulatory function which is not compatible with the administrative role envisioned for the act. Furthermore, as the minister is likely to act on a complaint of a member of the company, the ability of the minister to apply for the appointment of an investigator may allow a member to circumvent the provisions of the act.

On the other hand, the act does not allow holders of debt instruments or securities to apply for the appointment of an inspector. The added flexibility afforded to companies by many of the proposals in this paper could be used to the detriment of secured creditors. The possibility of a secured creditor applying to appoint an inspector may help prevent added flexibility from being abused. However, additional safeguards would be needed to ensure that the ability of a secured creditor to seek the appointment of an inspector is not abused. Such provisions exist in other jurisdictions.

It is proposed that the ability of the minister to apply for the appointment of an investigator be deleted, but that the holder of a debt instrument or security of a company be able to apply for the appointment of an investigator if that person can show

- there are reasonable grounds to believe the company has committed fraud, intended to commit fraud or was formed for a fraudulent purpose; and
- the interests of the security holder have been unfairly prejudiced.

No changes would be made to the provisions allowing a member to apply for the appointment of an investigator.

No transition provisions are required.

Pre-Emptive Rights

The present act contains restrictions on the ability of companies to offer shares to non-members. Section 41 requires non-reporting companies, with some exceptions, to offer shares to its members before offering the shares to non-members. A reporting company may offer the shares directly to non-members unless its memorandum or articles indicates otherwise.

These provisions are unique in Canada. Some Canadian legislation allows the corporate charter to provide pre-emptive rights to members. Others are silent on this point. There is even less uniformity in the United States where some states deny any pre-emptive rights, some states deny pre-emptive rights unless expressly granted, others expressly grant them, while others authorize some limitation of them in the articles (see Iacobucci, page 149). The United Kingdom *Companies Act*, 1980, introduced pre-emptive rights in accordance with the European Common Market directives on company law harmonization.

Pre-emptive right provisions are designed to prevent directors from diluting the interests of the existing members in the company. The provisions in the current act recognize that these concerns are especially strong in non-reporting companies because they are more likely to be closely-held, have less well-advised directors and members, and are subject to lower disclosure standards. The present provisions acknowledge that relying on a director's duty of good faith may not satisfactorily protect a member's interest in a non-reporting company.

However, pre-emptive rights have a number of disadvantages. The issuance of new shares is hindered and a new issue of shares for non-monetary consideration is made difficult. Pre-emptive rights also make it difficult for solicitors to verify that an outstanding share has been validly issued. Third parties who purchase shares may suffer if the directors have not complied with section 41. Finally, the pre-emptive rights contained in the act appear to be widely ignored in practice.

Provisions regarding pre-emptive rights should balance member protection with the flexibility a company needs to arrange new financing. The members should be able to choose whether they require pre-emptive rights.

However, the transition from mandatory to optional pre-emptive rights is problematic. Abolishing all mandatory pre-emptive rights, unless the company passes a special resolution, may be a trap for the unwary. A company that wishes to continue to have pre-emptive rights may be unaware that a special resolution is now required. On balance, it appears extinguishing pre-emptive rights should require a positive act on the part of either members or incorporators. However, that leaves the question of whether abolishing pre-emptive rights is such a fundamental change that members who dissent from the waiver resolution should have the right to require that the company purchase their shares. Comments on this issue would be especially appreciated.

It is proposed that section 41 be amended to provide that members (except members of reporting issuers) have pre-emptive rights to purchase newly issued shares unless

- the memorandum or articles of the company provide otherwise;
- the shares are issued for a consideration other than money; or
- any other exception contained in the current act.

Members would be able to require the company to purchase their shares if they object to their pre-emptive rights being removed by way of an amendment to the memorandum or articles.

No transition provision is required since positive action is required by a company to take advantage of the proposed change. However, section 41 will be amended to make it more workable for those companies who do not extinguish pre-emptive rights.

Financial Assistance

Section 127 of the current act restricts the ability of a company to provide financial assistance. Companies are restricted in their ability to provide loans and other financial assistance where the assistance is used to purchase shares in the company, or where a loan is secured by a charge against shares of the company. In other cases, the company may give financial assistance only where it is in the best interests of the company. Section 127 also contains a number of exceptions to these restrictions.

Section 127 has been criticized as being unnecessarily restrictive and cumbersome. There are a number of legitimate situations where a company may wish to provide a loan or other financial assistance for the purchase of its shares. Many of these situations are not covered by the exceptions contained in section 127.

Providing financial assistance may pose a danger to the creditors of a company. Like the payment of dividends, providing financial assistance decreases the capital available for the creditors. A company should not be able to impair its capital by granting financial assistance if the company is, or would, become insolvent. However, financial assistance should always be allowed where providing assistance is part of the ordinary course of business of the company.

The provision of financial assistance to members or directors of companies poses special problems. As with the repurchase of shares, allowing companies to give financial assistance to some members could frustrate the reasonable expectations of the other members of the company. Some investors in companies may have become members on the understanding that the directors could not use the capital of the company in this manner. Financial assistance could be used to discriminate against minority interests. This problem could be avoided by allowing the directors to give financial assistance for the purchase of shares only if the members of the company approve.

It is proposed that section 127 be amended to allow a company to give financial assistance for the purchase of its shares or to be secured by a charge against the company's shares if:

- the company can comply with the solvency requirements of section 126. "Solvency" will have the expanded definition set out in the section below, dealing with corporate share repurchases and redemption; and
- the financial assistance is authorized generally by the articles of the company, or specifically by a special resolution of the shareholders.

Financial assistance for any purpose other than the purchase of shares or financial assistance secured by a charge against shares would be permitted if the company is solvent.

A company would be able to provide financial assistance in the situations described in section 127(2) and (5) even if the company cannot meet the solvency requirements. As well, financial assistance given in the ordinary course of business of the company, or given to reimburse or guarantee an expenditure made on behalf of the company, would be exempt from the solvency requirement.

No transition provision is required.

Par Value Shares

Section 19 of the current act allows companies to issue both par value shares and shares without par value. This provision differs from other Canadian business corporation statutes which do not permit a company to issue par value shares.

A number of disadvantages with par value shares have been cited. The par value share concept was originally introduced to provide some protection to creditors, but proved ineffective. The intent of the rule could be circumvented by issuing shares in exchange for property of unproven value. The authors of the "Proposals for a New Business Corporations Law for Canada" believe that the concept of par value shares is arbitrary and misleading. They argued that a share is a proportionate interest in the net worth of a business, and the par value concept obscures this reality. It was also argued that par value shares generate accounting and disclosure confusion arising from such accounting concepts as "contributed surplus" and "distributable surplus."

However, not permitting par value shares would remove an option from persons establishing a company in British Columbia. Many tax lawyers and accountants feel that there will still be many types of transactions or reorganizations where shares without par value do not provide as much flexibility as par value shares. The trend for companies to set par value shares at $1 or $5 per share has lessened the potential for abuse and has reduced the significance attached to the expression "par value." Furthermore, par value shares may be more readily acceptable to Asian or European investors from jurisdictions that have not adopted the concept of shares without par value.

Although par value shares may lead to difficult accounting concepts, the decision to arrange business affairs in this manner should be left to the company and its advisors. The

danger of misleading investors does not appear to be serious enough to interfere with the operation of a company, given the disclosure requirements of securities legislation.

It is proposed that companies continue to be able to issue par value shares or shares without par value.

No transition provision is required.

Capital Arising from Shares Without Par Value

Section 42(2) of the current act indicates that the capital of the company in respect of shares without par value is the price or amount of consideration paid to the company for the shares. A share cannot be issued until the company has received the full consideration for it in cash, property or services. The company must value property or services it receives as consideration for shares at no greater than fair market value. Some practitioners feel that any consideration the company receives for its shares is locked in the company's capital account, subject to the rules relating to the return of capital. If this is the case, in some circumstances, this rule is unduly inflexible.

The purpose of the share capital account concept is to provide a cushion of ownership capital to protect creditors. British Columbia, and most other jurisdictions, prohibit companies from making payments or distributing assets to members which reduce the available assets of the company below the amount of capital in the capital account.

Creditors and members expect that the amount of capital in the share capital account will not be paid out except through bona fide commercial transactions and corporate procedures; thus, the rule that capital can be impaired by losses but not by dividends, share redemptions and conversions or payments to re-acquire the company's own shares.

In some circumstances, increasing the capital account by the amount of consideration received for the shares does not serve to protect creditors. Creditors are not prejudiced if the capital account is not increased for shares issued to members of an amalgamating body corporate who receive the shares in addition to, or instead of, securities of the amalgamated body corporate. All assets of the two companies are preserved when they are amalgamated. Similar considerations apply with respect to redeemable shares.

It is proposed that a company be able to increase its capital account by less than the consideration received for:

- redeemable shares issued as consideration for property or for issued shares of a different class or series of the company; or
- shares issued to members of an amalgamating body corporate who receive the shares in addition to or instead of securities of the amalgamating body.

No transition provision is required.

Negotiability and Transfer of Shares

Part 3 of the current act provides for the transfer and registration of shares and the issuance of share certificates. These provisions allow the transferability of the shares of a company to be governed by the memorandum and articles of the company. A company cannot register the transfer of a share unless an instrument of transfer is delivered to the company. Registration of shares is not a guarantee of title. A court may order the rectification of the register of members of a company or decide any other question relating to the title of a share. Every company must keep a register of allotments and a register of transfers, as well as keeping a register of members.

The provisions of Part 3 have made it difficult to use shares as negotiable instruments. Purchasers of shares must check the memorandum and articles, deliver instruments of transfer and allow for the possibility of court rectification. The rights of issuers, purchasers and members must be ascertained from the common law and jurisprudence.

Allowing British Columbia companies to use their shares as negotiable instruments would enhance their ability to raise capital. As was stated by the Institute of Law Research and Reform:

> Present business practice treats corporate securities as if they are negotiable. It is common for them to pass from hand-to-hand by endorsement or the signing of a simple transfer form, together with delivery of the security.... Treating securities as virtually negotiable facilitates, and indeed is probably necessary for, the workings of capital markets, and it seems clear that recognition of negotiability

by law is desirable to facilitate business and to bring the law into conformity with business practice.

Article 8 of the Uniform Commercial Code provides a complete code in respect of negotiable securities and has gained widespread acceptance. The *Canada Business Corporations Act*, the *Ontario Business Corporations Act* and the business corporation statutes of the other western provinces have all adopted provisions based on Article 8 of the Uniform Commercial Code. Adopting these provisions would make the British Columbia law uniform with other jurisdictions in an area of law where uniformity is especially important.

These provisions are too detailed to be fully described here, but they provide a comprehensive code governing the rights of issuers, security holders and transferees. Some of the significant aspects of the law are as follows:

- companies are not required to keep a register of allotments or a register of transfers;
- securities are negotiable and no purchasers are bound by any restrictions regarding the transfer of the security, unless the restriction, or lack of negotiability, is noted on the face of the security;
- a purchaser in good faith of a security acquires the security free from any adverse claims. In most cases, the purchaser acquires good title to the security. If the purchaser registers the transfer of the security in the company's records, the purchaser always acquires good title, even in cases of fraud or forgery;
- an issuer can refuse to register a security only if the transfer is not lawful, or if the presenting transferee is not a bona fide purchaser; and
- the security must be honored by the issuer when presented by a purchaser for value, except where a security is forged. Even an unauthorized signature by the issuer's agent cannot be invoked as a defense by the issuer.

Full negotiability of securities is also a pre-requisite to allowing uncertificated or book-based securities as proposed in chapter 11.

It is proposed that a corporate securities transfer code — uniform with Part VII of the *Canada Business Corporations Act* and Article 8 of the Uniform Commercial Code — be adopted.

Transition provisions will be required to give companies a chance to ensure that any restrictions on transferability are placed on the face of securities.

Three possible methods exist for dealing with shares issued before these provisions are enacted. First, the act could declare all shares issued before these amendments are enacted to be non-negotiable. This option has the disadvantage of creating a permanent class of shares which appears to be negotiable but which, in fact, is not.

The second option would be to require companies, within a set time, to cancel all their share certificates and re-issue shares in either negotiable or non-negotiable forms. This option would create a period of considerable confusion, as well as constituting a trap for the unwary.

The third option would be to immediately deem existing shares as being negotiable unless they happen to state otherwise. The companies would have the ability to call in their existing share certificates and re-issue them in non-negotiable form.

The principal drawback to this option — companies being unaware that their shares are now negotiable — can be reduced by publicizing this change as widely as possible.

It is proposed that the third option be adopted, as it provides the greatest certainty for all parties.

Corporate Share Repurchases and Redemption

Section 259 permits a company to purchase or redeem shares subject to a number of restrictions. A company cannot redeem or purchase its shares or, for that matter, make a dividend payment if the company is insolvent or would become insolvent as a result of the transaction. The act defines "insolvent" as including the inability of a company to pay its debts as they become due in the usual course of business.

A share repurchase must be made through a stock exchange, from a *bona fide* employee or former employee or based on a *pro rata* offer to all the members holding shares of the same

class or series. A redemption of shares must be made on a *pro rata* basis unless the memorandum or articles provide otherwise.

Several additional safeguards exist in the act to ensure that repurchases of shares are not abused. Under section 151, a director may be personally liable if the company redeems or purchases its shares while insolvent. Under section 260, a director may apply to court to determine if the company is insolvent.

The ability of a company to repurchase shares has proven to be controversial. *The Report of the Company Law Committee* (1962) Cmmd. No. 1749 (Jenkins Report), as well as a similar committee in South Africa, rejected the arguments in favour of allowing companies to purchase their own shares. On the other hand, the *Interim Report of the Select Committee on Company Law* (Lawrence Report), Ontario Queen's Printer, 1967, recommended companies be allowed to purchase their common shares, and most jurisdictions in Canada and the United States allow companies to do so.

The protection of creditors requires that a company not be permitted to repurchase or redeem its shares if it is insolvent. Creditors have the right to assume that the claims of members on the company's assets will be subordinated to the claims of creditors. Members should not be able to withdraw their investment in the company or receive any return from the investment if there is any question of creditors receiving less of the money owed to them as a result of the payment to the members. However, banning of share repurchases would seem to be an extreme measure to protect creditors from this potential abuse. Not allowing share repurchases would also prevent many valid and beneficial transactions which do not prejudice anyone's interest.

There are two problems with the provisions permitting a company to purchase and redeem shares. First, the definition of insolvency may allow a company to purchase its own shares when its liabilities exceed its realizable assets (balance sheet test of insolvency), as long as the company has the liquidity to pay its current debts (cash flow test). It is unclear whether or not the balance sheet test applies because the definition of insolvent says "includes" rather than "means." Most other jurisdictions' definitions of insolvency clearly apply both the balance sheet and the cash flow test.

Second, the requirement that repurchases (except those on a stock exchange or from employees) must take place on a *pro rata* basis, robs the provision of much of its utility. One can envision many circumstances under which a company has a legitimate desire to purchase the specific shares of one or more of its members that is in the best interests of the company and does not prejudice other members or creditors.

If the *pro rata* repurchase and redemption requirement is relaxed, members may require some additional protection. If companies are to be allowed to repurchase shares outside of a regulated stock exchange from a particular member rather than on a *pro rata* basis, then the reasonable expectation of other members could be frustrated. This could be avoided by allowing all members, or members of a specific class, to dispense with the requirement that shares be repurchased on a *pro rata* basis, should circumstances warrant.

It is proposed that the provisions governing share repurchases and redemptions be amended by:

- expanding the definition of "insolvent" to mean either where the realizable assets of the company are less than its liabilities or where obligations cannot be paid when they come due. A company would not be able to purchase or redeem its shares or pay dividends if it is insolvent;

- continue to allow a directors' resolution to authorize the purchase or redemption of shares by a company as long as the company is not insolvent and is permitted to do so by its articles; and

- continuing to require a company to purchase (other than a purchase on a stock exchange or from an employee) or redeem its shares on a *pro rata* basis unless its articles indicate otherwise or a special resolution is passed to authorize a particular purchase. A member dissenting to a special resolution amending the articles or approving a repurchase would be entitled to have the member's shares purchased using the dissent remedy.

No transition provision is required.

Purchase of Shares by a Subsidiary

Most jurisdictions prevent a subsidiary from purchasing the shares of its parent. British Columbia is unique in Canada in that the act does not expressly deal with this issue. This has been interpreted as providing an unrestricted ability for a subsidiary to purchase the shares of its parent.

The policy reason for preventing a subsidiary from purchasing its parent's shares seems to be to prevent the restrictions on redemptions and purchases of the parent's own shares from being effectively circumvented. However, there are legitimate circumstances where a purchase of the parent's shares by a subsidiary is in the best interests of both the parent and the subsidiary and not detrimental to the interests of members or creditors. It seems unnecessarily restrictive to eliminate this option altogether in order to protect the integrity of the redemption and repurchase provisions.

It is proposed that subsidiaries be clearly permitted to purchase the shares of their parents, but that such purchases only be allowed in circumstances when the subsidiary is solvent and a share repurchase by the parent would be allowed. The purchase by a subsidiary of its parent's shares would be subject to the same conditions regarding a *pro rata* offering as a repurchase by the parent of its own shares.

No transition provision is required.

Decrease of Share Capital

Section 257 allows any company to reduce its capital with the approval of the court. If the reduction in the capital involves either a diminution of liability with respect to unpaid capital or the payment to any member of any paid up capital, the court must be satisfied that every creditor entitled to object to the reduction of capital has consented or the debt has been discharged.

The procedure contained in sections 257 and 258 for decreasing share capital has proven so cumbersome that it is rarely used in practice. Court applications are expensive, and doubt has been expressed as to the provisions' effectiveness in safeguarding interests. It has also proven to be difficult to compile a list of creditors.

The issues involved with decreasing share capital are similar to the issues involved with a company purchasing its own shares. Creditors are entitled to assume that the capital of the

company will not be deliberately impaired to their prejudice. Members are entitled to assume that the capital they contributed to the company will not be paid out except for *bona fide* commercial purposes.

It is proposed that the need for court approval of a reduction in capital be eliminated. A reduction of capital involving a paying out of paid-up capital or a waiver of liability of unpaid capital will not be permitted if the company would be rendered insolvent, with "insolvent" having the new definition proposed above. A company that is solvent could reduce its capital by passing a special resolution. The directors would have to indicate that the company is solvent before the special resolution is voted on. As with redemptions, purchases of shares and payments of dividends, the directors would be personally liable if the company is not solvent.

No transition provision is required.

Constrained Shares

Section 20 of the act permits the memorandum and articles of a British Columbia company to restrict the ownership and transfer of shares. The act does not specify when or what type of restrictions may be imposed.

In contrast, the *Canada Business Corporations Act* and its regulations explicitly provide for and regulate constrained share companies — companies which restrict the ownership of shares to Canadian citizens or residents. The *Canada Business Corporations Act* and, to a greater extent, the *Ontario Business Corporations Act*, limits the type of restrictions that may be placed on the ownership and transfer of shares.

The drafters of the Dickerson Report, upon which the *Canada Business Corporations Act* is based, commented as follows:

> It is not for us to decide the extent to which nationalism should be a factor in the regulation of business, and we do not debate that general issue. We think we are entitled to say, however, that it has no place in a corporation act ... the point is that a corporation act should not lay down the circumstances under which restrictions should obtain, nor the nature of the restrictions. It should merely provide machinery by which these restrictions, wherever or however decided, can be implemented.

Limiting when a company may impose any restrictions on the ownership and transfer of shares is an unwarranted restriction on the flexibility of incorporators. Incorporators should be able to decide on the type of restrictions and on the mechanism for enforcing the restrictions.

It is not proposed that any provisions limiting or regulating when a company may restrict the transfer or ownership of its shares be included in the legislation. However, as discussed in chapter 2, any restrictions would have to be set out in the memorandum.

No transition provision is required.

Indoor Management Rule

The current *Company Act* is silent on whether a deficiency in the internal procedure of a company has any impact on third parties dealing with the company. As a result, the case law following the *Royal British Bank v. Turquand* decision sets the rule. The effect of the cases (the "indoor management rule"), may be summarized as follows:

> ... where a party dealing with the company ascertains the existence [of power] on the part of the company to do the act, that is to make and give him the obligation, he may go on with the dealing without inquiring as to the formalities that may have been prescribed as preliminaries. He may presume without inquiry that these have been properly attended to ... (*Sheppard v. Bonanza Nickel Mining Co. of Sudbury*, (1984), 25 O.R. 305 (Ch. Div.).)

In contrast with the British Columbia act, many of the business corporation acts in Canada have codified the common law in this area, and have statutory indoor management rules.

The common law in this area appears to be functioning reasonably well, although a number of complex rules and exceptions have evolved (see Gower, pp. 150–169). As well as being unnecessarily complex, the common law appears deficient in two respects.

The first is that the common law protects only "outsiders" — persons who are strangers to the company. It is sometimes difficult to determine whether a party qualifies for protection under the rule. Second, the common law rule applies only to a genuine transaction that is nullified due to an irregularity. It does not apply to forgeries.

A clear and definite indoor management rule is necessary for companies to operate efficiently. A company could not carry on business if everyone who had dealings with the company had to scrutinize its internal operations. Statutory codification of the rule would help ensure that it operates clearly and without ambiguity.

There does not appear to be any policy reason to distinguish between forgeries and other irregularities. It is often as difficult to determine the validity of a signature as it is to determine if a transaction is properly authorized.

It is proposed that an indoor management rule be included in the act under which companies would be prevented from asserting against a person dealing with the company that:

- the memorandum and articles have not been complied with;
- the persons named in the most recent Notice of New Directors are not the current directors;
- the place named in the Notice of Office, or if applicable, the most recent Notice to Change Office is not the registered office of the company;
- a person appointed by the company as officer, director or agent does not have the usual authority of an officer, director or agent;
- a document signed by a person usually having authority to sign a document on behalf of a company is not a valid document; or
- financial assistance or a sale, lease or exchange of the undertaking of the company was not authorized.

The only exception to this rule would be where the person dealing with the company knows or ought to know differently.

For transition purposes, it would be clarified that the rule would apply to any transaction after it is enacted, but would not apply to any action commenced prior to the provision taking effect and continuing at that time. It would also be clarified that the common law would continue to apply to actions commenced prior to the provision taking effect.

Special Resolutions

Part of the definition of "special resolution" in section 1 of the current *Company Act* requires that the resolution be passed by a majority of $^{3}/_{4}$ of the votes of members of the company voting at the meeting. Special resolutions are required to approve changes which could affect the fundamental rights of the members (for example, removing a director before the expiration of the director's term, or altering a restriction on a company's ability to carry on business).

A majority of the jurisdictions in Canada have adopted a definition of special resolution which requires only a two-thirds majority to approve the resolution.

The current definition of special resolution has a number of disadvantages. The requirement that $^{3}/_{4}$ of the votes of members approve a resolution may restrict the flexibility of a company to adapt to changes and force companies to incorporate or continue outside of British Columbia. The $^{3}/_{4}$ requirement may also give members with a minority interest an unwarranted influence in the affairs of the company.

The majority requirement for special resolutions must balance the ability of the company to adapt to changes against the protection of members with minority interests. In some circumstances, an investor in a company may wish for the security inherent in requiring unanimous approval for a special resolution. In other circumstances, investors may prefer the flexibility of requiring only majority approval for a special approval. Some commentators have stated that the $^{2}/_{3}$ majority rule provides a better balance between these two requirements (see, Iacobucci, pages 153 – 154). However, the incorporators and members of the company are best able to decide on how to balance the need for flexibility with the protection of the minority, within limits.

A more flexible approach to setting the majority needed to pass a special resolution would remove the need to provide for unanimous shareholder agreements. The ability of articles to define the duties and powers of directors, as well as the ability to require unanimous consent to alter the articles, would fill the role played by unanimous shareholder agreements under other jurisdictions' legislation.

It is proposed that companies be permitted to define in their articles the majority needed to pass a special resolution as any percentage of votes greater than or equal to 66 per cent, including 100 per cent. Once the percentage of votes needed for approval has been set in the articles of the company, it could only be changed by special resolution. If there is no provision in the articles, the default majority would remain at 75 per cent, minimizing the disruption of this change.

No transition provision is required.

Section 163 of the current act requires a company to hold an annual general meeting every year, no more than 13 months apart. The act allows the Registrar to extend the time in which a company is to hold the meeting for one six-month period. At the annual general meeting, the company must present its financial statements for the period ending no more than six months prior to the date of the annual general meeting. If the company has completed a financial year, the statements must also represent the most recently completed financial year. The financial statements must include the report of the auditor if the company is either a reporting company or has not passed a resolution waiving this requirement.

These provisions pose difficulties for companies that have not been able to hold an annual general meeting within the required time. The discretion given the Registrar cannot be exercised retroactively, nor can the time period be extended for longer than six months. It may be impossible for a company to produce an auditor's report if several years have passed since the last report was produced.

The importance of annual general meetings and financial statements vary greatly from company to company. In small, closely-held companies, annual general meetings and financial statements can be unnecessary technicalities. In larger companies, they help ensure that the interests of members are adequately protected. The provisions in the *Company Act* should be flexible enough to accommodate both types of companies when they have not held an annual general meeting within the required time.

It is proposed that companies be able to extend the time limit for holding an annual general meeting, waive the holdings of past annual general meetings, or delete the requirements of producing financial statements if the members of the company consent unanimously. In the case of a waiver of a financial statement, non-voting members must also consent. Alternatively, if the company is not a reporting issuer, then the company could apply to the Registrar to extend the time limit for holding the annual general meeting. A company that is not a reporting issuer could also apply to the court for an order dispensing with the need for some or all of the financial statements. The Registrar and the court would be able to attach conditions to any order made under these provisions. Consideration is being given to whether similar provisions should apply to reporting issuers.

No transition provision is required.

Location of Annual General Meeting

Section 170 requires a general meeting of a company to be held in the province unless the Registrar approves another location. The Registrar rarely denies an application to hold a meeting outside the province. Nevertheless, applying to the Registrar for an exemption does involve some delay and expense.

Requiring the meetings to be held in British Columbia ensures that most British Columbia resident members are able to attend the meeting. On the other hand, the residence of a member, or the location of the company, or some other reason may suggest that the location of the annual meeting should more appropriately be outside the province. The members of the company should be able to decide for themselves where its annual meetings should be held, as long as the interests of all the members are protected.

It is proposed that the requirement that annual meetings of a company be held in the province continue, but that two additional exceptions be provided. An annual meeting could be held outside the province if

- the articles of the company specify other locations where the meetings could be held;
- a particular location for the next meeting is approved by special resolution; or
- the Registrar consents.

No transition provision is required as the company must undertake a positive act in order to change the status quo.

Requisition for General Meeting

Section 171 of the current act provides a method for members to require the directors of the company to call a general meeting of the company. The directors must hold the meeting within four months of receiving the members' requisition.

The directors of the company must be given enough time, after receiving a requisition, to organize a general meeting. However, four months appears to be excessive, given that the members may have a concern which may have to be addressed promptly.

It is proposed that the act be amended to require directors to call a general meeting to be held within 90 days of receiving a

requisition. This change would apply to all requisitions received after the provision takes effect.

No transition provision is required.

Quorum

Sections 168 and 172 of the current act provide rules for determining the quorum at meetings of a company. Section 168 states that subject to the articles of the company, the quorum at a general meeting is two. If there is only one member, then the quorum is one, despite any provision in the articles to the contrary. In contrast, section 172 states that a quorum at a class meeting is at least one person holding or representing, by proxy, one-third of the shares affected.

There does not appear to be any reason why the quorum requirements of general meetings and class meetings should differ. Furthermore, it would simplify corporate practice if, whenever the number of members is less than the quorum set in the articles, the act deemed a quorum to be all the members of the company. Nobody's interests are likely to be affected by such changes.

It is proposed that sections 168 and 172 be combined so that a quorum for both a class meeting and a general meeting will consist of at least two persons, unless the articles of the company provide otherwise or unless there is only one member or class member. If there are fewer members than the number required by the articles for a quorum, it is proposed that the quorum will be all the members. This provision would apply to all meetings held after the provision takes effect.

No transition provision is required.

Notices to Directors and Members

Section 186 of the current act provides that notices, statements or reports that have been properly mailed shall be deemed to have been received on the next business day. It does not appear reasonable to assume mail can be proceed this quickly. Section 228 permits service on a company by mail or personal service. Further rules regarding the service of notices may also help the management of companies.

It is proposed that

- mail be deemed to be received five (5) working days after it has been sent. This provision would apply to all parties, including the company and its members;
- the addresses of members and directors be deemed to be the last address shown on the records of the company; and
- there be an ability to waive, in writing, the receipt of any notice or statement.

No transition provision is required.

Notices of General Meetings

Section 135 of the current act requires reporting companies to publish notices of general meetings at which directors are to be elected. These notices must be published at least 56 days before the meeting and must state written nominations for the position of directors. Companies must mail nomination material with any proxy forms or information circular sent by the management of the company if the nomination material is delivered to the company at least 35 days in advance of the meeting.

The requirement to publish notices of meeting is expensive and difficult to comply with. Companies have practical problems complying with the 56-day time period.

The election of directors can be the most direct and powerful method members have of ensuring their interests are protected. These provisions recognize that management of large, public companies often have a nearly overwhelming say in the choice of directors. The ability to nominate directors from the floor, as well as to distribute nomination material for an alternate slate of directors, acts as an important check on management's power. Neither of these provisions are an undue burden on the efficient management of a company.

However, the benefits of requiring companies to publish notices of meetings may be outweighed by the disadvantages. The nomination of an alternate slate of directors requires a certain degree of sophistication and interest. A person having this sophistication and interest is unlikely to be aided by a published notice. Furthermore, the preparation of an alternate slate is likely to take longer than the 56-day minimum period set out in the act.

It is proposed that the requirement that reporting companies publish advance notices of meetings be eliminated. However, members would continue to be able to require companies to circulate material relating to the election of directors.

No transition provision is required.

Cumulative Voting

The current act is silent on a type of voting for company directors known as "cumulative voting." Cumulative voting allows a member to cast as many votes for a director as the member has shares of the company, multiplied by the number of directors to be elected. Cumulative voting enables minority interests to concentrate the total number of their votes upon a single candidate or group of candidates.

Cumulative voting may help ensure that directors represent the interests of all members. This method of electing directors makes it easier for members with minority interests to elect their representative to the board of directors. On the other hand, cumulative voting may not be suitable for all companies:

> ... cumulative voting is somewhat controversial and may be thought more appropriate to small closely-held corporations where shareholder control is considered important than to large publicly-held corporations where stability and harmony in management is considered the dominant interest (Dickerson, paragraph 206).

Each company should be able to decide for itself whether to adopt cumulative voting for the election of directors. However, where a company does adopt cumulative voting, the act should ensure that it is effective.

It is proposed that cumulative voting for directors continue to be optional, but that the act better accommodate cumulative voting. A decision to adopt cumulative voting would automatically trigger a number of companion restrictions. If the memorandum and articles provide for cumulative voting, then the act would not allow the number of directors to be reduced, or a particular director to be removed, if the votes cast against the motion were sufficient to elect a director. A company having cumulative voting would be required to have a fixed number of directors, and the term of office of all of the directors would expire at a set time.

As a transitional provision, companies having cumulative voting rules which conflict with the requirements of the act when the changes take effect would be deemed to have the rules changed so that they do not conflict.

Chapter 7 — Types of Companies

Reporting Companies

The current act applies to both public ("reporting companies") and private companies. The act imposes additional requirements regarding proxy solicitation, financial statements, the nomination of directors and other matters on public companies. Private companies have less onerous provisions covering the same types of issues.

The *Securities Act*, its regulations and the policies of the Securities Commission regulate many of the same aspects of a public company. The *Securities Act* is designed to provide investors with current information as a basis for investment decisions and to ensure that holders of securities are treated fairly. The policy objectives underlying the "reporting companies" provisions of the *Company Act* are similar to the policy objectives of the *Securities Act*. For example, the *Securities Act*, its regulations and related policies provide for financial statements, audits and proxy solicitations.

The overlap in the two statutes causes redundant (and confusing) regulation. The problem is compounded by the fact that the definition of "reporting company" in the *Company Act* is different than the definition of "reporting issuer" in the *Securities Act*. No policy reason exists for this difference. There are some reporting companies that are not reporting issuers, but are still required to provide public access to financial records.

The overlap in regulatory responsibility should be eliminated. The definition of "reporting issuer" in the *Securities Act* will cover most public companies (i.e., companies which require special regulation to safeguard the public).

In order to better coordinate regulation of public companies, the special requirements of public companies for the purposes of securities regulation should be dealt with only in the *Securities Act*, its regulations and administration. Corporate law issues for public companies would continue to be dealt with in the *Company Act*. The determination of which provisions currently in the *Company Act* should be deleted because the issue is already addressed in securities law or should be moved to securities law will be determined on a case-by-case basis, in consultation with the Securities Commission.

It is proposed that the concept of reporting companies in the *Company Act* be largely replaced by the concept of reporting issuers, as defined in the *Securities Act*. The special provisions dealing with securities regulatory issues for reporting companies in the *Company Act* would be eliminated, although there would continue to be some provisions of the *Company Act* which would apply only to public companies. The *Securities Act*, its regulations and policies would also have to be amended to ensure that all the necessary issues are covered.

Transition provisions may be necessary to deal with those companies that fall within the definition of "reporting companies," but not within the definition of "reporting issuer."

Specially Limited Companies

The *Company Act* makes provision for a separate type of company known as a "specially limited company." These companies have memorandums which restrict the business to mining and exploration and which limit their ability to lend money or to provide guarantees. These companies are distinguished by having "non-personal liability" or "N.P.L." in their name. The only other significant feature of these companies is that they are not restricted in the discount or commission allowed when shares are issued.

There does not seem to be any policy reason to continue this special type of company. It seems to be a vestige of the time when companies did not have the powers of a natural person. Any company can limit its business or powers in its memorandum, if it chooses. While a specially limited company cannot amend its memorandum, it can convert to a regular company by special resolution and is then free to amend its memorandum by special resolution.

The commission and discount issue is one that is more appropriately dealt with under securities regulation. Other securities related issues for specially limited companies can still be addressed without having a special category of company.

It is proposed that the designation "specially limited company" and special rules applying only to specially limited companies be eliminated. When the amendments come into effect, these companies will be treated, for the purposes of the *Company Act*, as other companies. Special provisions may continue to apply under securities regulation.

As a transition measure, shares which have not been fully paid for shall be deemed to be shares without par value with a paid-up capital, equal to the value of what has been paid for the share.

Chapter 8 — Offices, Records and Financial Statements

Refusal to Provide Access to Corporate Records

Sections 39 of the current act requires companies to have records offices. Section 188 permits directors, members and the public access to the records kept at such offices. Section 193 provides that a company commits an offence when it refuses to allow access to its records, but does not set out the consequences of an agent of the company refusing access to the records.

The refusal by companies to provide access to company records is a frequent complaint. The proposals set out in chapter 2 to simplify incorporations and reduce filings require that access to company records be strengthened. Inability to access the records offices of a company would be more serious. The commercial reality in this province is that many, if not most, corporate records offices are located in the offices of the company's solicitors or other agent of the company. People who agree to accept the responsibility of keeping a company records office should be required to provide public access to the records.

It is proposed that the act be amended to make it an offence for an agent of the company to refuse to provide access to records which the company must keep at its records office and to explicitly provide for injunctive relief to allow a person to enforce compliance.

No transition provision is required.

Records Office Documents

Section 187 of the current act requires companies to keep 24 categories of documents at their records office. These documents include not only financial records and documents comprising the corporate charter, but also other documents such as mortgages and instruments approved by directors. By comparison, the business corporation statutes of other jurisdictions require companies to maintain considerably fewer documents at their records office.

The purpose of a records office is to provide information to the public and to the members of the company. Companies should not have to maintain documents which are already accessible

to the public at a registry or through another statutory mechanism, such as that provided by the *Personal Property Security Act*.

It is proposed that companies be required to maintain only the following documents at their records office:

- documents comprising the corporate charter (memorandum, articles and amendments);
- the securities register which would replace the register of members, register of transfers and register of allotments as a result of the proposals in chapter 5 on the negotiability and transfer of shares;
- a register of directors;
- a register of senior officers (see List of Officers in Annual Report, chapter 3);
- the minutes and resolutions of every meeting of the members, the directors and, where the company is being wound up, the creditors;
- copies of every written contract under which the company has allotted shares for consideration other than cash;
- a copy of audited financial statements; and
- where the company is an amalgamated company, copies of the required documents of each of the amalgamated companies.

Companies would no longer have to maintain copies of prospectuses and circulars (paragraphs 187(1)(v) and (w)), documents on file at the Corporate Registry (paragraphs 187(1)(m), (n) and (o)), registers of debentures and indebtedness and copies of mortgages (paragraphs 187(1)(h), (i) and (r) covered by the *Personal Property Security Act*) and other documents approved by the directors (paragraph 187(1)(q)).

This proposal could prevent a member of a company from reviewing the actual mortgage document executed by the company. A search of the appropriate registry may reveal the existence of an encumbrance, but the actual document creating the encumbrance may not be available to the member unless

the company consents. Nonetheless, the requirement to keep copies of company mortgages at the records office does not appear to be a significant benefit to members. In practice, the company records office rarely has a complete record of mortgages. Furthermore, rarely will the managers of a company deny a member a copy of a mortgage. The cost of keeping these documents appears to outweigh the benefits, although comments on this specific point would be appreciated.

No transition provision is required.

Changing Registered and Records Offices

Section 40 of the current act requires a directors' resolution to change the location of a company's records office or its registered office (for convenience, both the offices will be referred to below as the "company office"). A change in the company office is not effective until the Registrar receives the notice of change of office.

The provisions in the current act give rise to two problems. One problem is that a directors' resolution is almost always required, even for a change that may be largely administrative. A change as small as moving the company office across the street should not require a directors' resolution.

A different problem is faced by law firms and others who provide companies with company office services. There is no way for these firms to resign as the company office if the directors do not pass the necessary resolution. This is inconvenient and sometimes expensive for parties named as the company office of an inactive company.

The proposals outlined in chapter 2 of this paper require the members of a company to place greater reliance on the records maintained at a company office. It may be in the members' interests to require the company office to be located close by, especially in small, closely-held companies. Members may not have easy access to company records if the company office is located in another part of the province. Requiring a directors' resolution to move a company office does not protect this right of the members, except in a very indirect fashion. On the other hand, moving a company office within a limited geographic area does not affect members and is purely administrative.

Aside from the members of the company, the public at large

also has an interest in ensuring that company offices are maintained. Registered offices allow the public to serve documents on companies that are otherwise inactive, but could be revived for purposes of litigation. Records offices also allow the public access to documents that are relevant even if the company is no longer active. For these reasons, as long as a company exists, there must be either a company office or some method of serving a company. Anyone who agrees to provide that service does so knowing that a company office is necessary, even if it becomes impossible to obtain a directors' resolution to move it.

It is proposed that section 40 be amended to allow the articles of a company to specify a municipality or geographic area within which the company must maintain a company office. A company would be able to change its company office within this geographic region by filing a form signed by an officer, director, receiver, liquidator or trustee of the company.

To facilitate transition, a directors' resolution would continue to be required (although not filed with the Registrar) unless the articles specify otherwise.

It is also proposed that a person providing registered office services on behalf of a company be allowed to apply to the Registrar to be relieved of that obligation and to move the registered office to the address of a director or officer of the company. The act would require the person to provide a statutory declaration to the Registrar giving the grounds for the person's belief that the new address for the registered office is the address of a director or officer. Furthermore, the third party would be responsible for any damages suffered by a member of the public if the address provided is not, in fact, the address of a director of the company.

It is also proposed that persons maintaining a registered office on behalf of a company be able to apply to the Registrar to eliminate the registered office of the company altogether. The act would require the person to provide a statutory declaration listing the steps taken to find a director of the company. If it appears impossible to ascertain the whereabouts of the director, then the registered office of the company could be eliminated. Service on the company would then be accomplished by advertisements in a local newspaper or other means, consistent with the Rules of Court respecting service when a person cannot be located.

Access to Company Records

The current act determines access to company records according to the relationship of the searching party to the company. Directors are allowed access to all company records. Members are allowed access to all company records except for directors' resolutions, documents approved by the directors and mortgages created or assumed by the company. The public can examine all records available to the members, except the minutes of members' meetings and the audited financial statements of a non-reporting company.

These provisions are consistent, although not identical, with other business corporation statutes in Canada. Other statutes also restrict a member's access to directors' minutes, and restrict more severely access by the public to company records of private companies.

The restricted access to company information may not always be warranted. Members who have contributed equity to the company and elected its directors do not have access to all company information under the current act. Purchasers of share options and other rights to purchase shares are also denied full access to company information.

Provisions regarding access to company information must balance the rights of members to monitor their investment with the need of companies to maintain the confidentiality of information.

Members require information to ensure that the company is being properly managed. On the other hand, allowing full disclosure of all information may make it easier for competitors of a British Columbia company to obtain an unfair advantage. Purchasing one share of a public company should not give a competitor full access to all company discussions. Members of a company are best able to decide for themselves how to balance these competing interests.

It is proposed that companies be permitted to amend their articles to allow members access to all company documents including directors' minutes. Persons having rights to purchase shares (e.g., warrants) would have the same access to information as members. No changes are proposed to public access to information.

No transition provision is required.

Preparation of Financial Statements

All companies are required to produce annual financial statements at their annual general meeting. Division 3 of Part 5 stipulates the content of interim reports of reporting companies and the use of consolidated statements. Division 3 of Part 6 sets out the duties and rights of auditors.

The act may be too rigid when dealing with financial statements. The practice of accounting is rapidly evolving and changing. The requirements of these two divisions may interfere with management's ability to prepare financial statements and with auditors in the preparation of meaningful audit reports. The act should reflect the flexibility needed by accountants, auditors and companies to prepare and use financial statements. As discussed in chapter 7, the regulation of financial statements prepared by reporting issuers may be best left to the *Securities Act* and its regulations.

It is proposed that the act be amended to repeal sections 197, 200, 201, 214, 215 and 216. In their place would be a general requirement that financial statements of all companies be prepared according to generally accepted accounting principles. Companies that are not reporting issuers would not have to produce financial statements if all of their members waive this requirement. Special provisions regarding the preparation of financial reports of reporting issuers would be set out in the regulations to the *Securities Act* or policies of the Securities Commission.

No transition provision is required.

Qualifications of Auditors

Part 6 of the *Company Act* requires every company to have an auditor. An exception is made for non-reporting companies which may not appoint an auditor if all of its members consent in writing to waive the appointment of an auditor. If the company is a reporting company, the auditor must be a member of either the Canadian Institute of Chartered Accountants, or the Certified General Accountants' Association of British Columbia, or a person certified by the Auditor Certification Board. No qualifications are necessary to be the auditor of a non-reporting company.

These provisions do not provide adequate protection for members of companies that are not reporting issuers. The right of a member of a company to have the financial statements of a company audited is a fundamental right which can only be

waived with unanimous approval. At least one member of a company must want an auditor's report if an auditor's report is prepared. That member should have the assurance of knowing that the auditor's report was prepared by qualified individuals.

It is proposed that auditors of companies that are not reporting issuers have the same qualifications as those required of auditors of reporting issuers.

No transition provision is required.

Audit Committees

Section 211 requires reporting companies to have audit committees. The majority of the committee must consist of "outside directors" (i.e., directors who are not officers or employees of the company or an affiliate). The audit committee must review the audit and may require the auditor to appear before them to answer questions.

Increasingly, jurisdictions are requiring public companies to have audit committees. A majority of the business corporation statutes in Canada (including the statutes of Ontario, Alberta, Nova Scotia and Canada) have provisions very similar to section 211.

However, audit committees pose a number of problems for companies. What constitutes a "review" of an audit report is unclear. For some companies a review may be a cursory examination of a report. For other companies, it may consist of attempting to substitute the views of the board for the views of the auditor. The audit committee does not have any ultimate authority as the auditor's report must also be submitted to the board as a whole. The vagueness in the function (and, thus, responsibility or liability) of the audit committee may lead to problems in some companies in attempts to recruit qualified outside directors. Some directors are reluctant to sit on audit committees in fear of incurring greater liability than other directors.

On the other hand, since the board as a whole must approve financial statements and the board receives the report of the auditor, arguably the audit committee members face no greater liability than other board members.

The *Report of the Commission to Study the Public's Expectations of Audits* (The Canadian Institute of Chartered Accountants, 1988) recommended that

> The CICA and the provincial institutes of chartered accountants should press for changes in the law to require that (1) boards of directors draw up and publish to the shareholders a formal statement of responsibilities assigned to the audit committee, (2) audit committees report annually to the shareholders on the manner in which they have fulfilled their mandate, and that (3) audit committees review both interim financial statements and annual financial statements before publication.

While these recommendations would help to address the mandate issue, there is also the question of the audit committee's separation from the management of the company. The Alberta proposal had the following to say about the latter issue:

> A common criticism levelled against the modern public company is that the Board of Directors tends to be composed of, or dominated by, the full-time "managers" of the corporation who, by means of majority election and the proxy systems, are able to perpetuate their control over the corporation and are essentially answerable only to themselves. This absence of any real *supervision* of management by the elected representatives of the shareholders has led to the institution in Germany, and elsewhere in Europe, of a formalized two-tier system of Supervisory Board and Management Board. Elsewhere it has led to the appreciation that "outside" directors, provided they genuinely represent the interests of the shareholders, perform a valuable function (at page 105).

Audit committees composed of a majority of outside directors ensure that management of companies does not dominate the audit process. Allowing the board of directors (which will likely be dominated by management) to define the responsibilities of the audit committee may frustrate its purpose.

An audit committee should ensure that management has cooperated in the preparation of the audit, and that the auditor has not been subject to undue pressures. Defining this purpose more clearly may provide guidance to audit committees and may make the recruitment of outside directors easier.

It is proposed that audit committees be required to review all financial statements and audit reports and report to members about

- **any serious differences of opinion between the auditor and management concerning the audit;**
- **any lack of explanations or information given to the auditor;**
- **any deficiencies the auditor has perceived in the financial management of the company; and**
- **the extent of non-audit work undertaken by the auditor for the company.**

As a transition provision, this would apply in respect of a company's first fiscal year to begin after the changes come into force. Audit committees would only be required of reporting issuers.

Independence of Auditors

Several sections of the current act ensure that auditors are independent from the company. Section 207 imposes an explicit requirement that auditors be independent and provides a number of circumstances which violate this requirement. Section 209 requires an ordinary resolution to be passed at a general meeting to remove an auditor before the expiration of the auditor's term of office. An auditor also has an opportunity to make written representations to members of the company regarding a possible termination. Similar provisions exist in other business corporation statutes.

These provisions do not guarantee independence of the auditor. A qualified audit opinion often leads to severe strains on the relationship between the management of the company and the auditor. The fear of losing the account at the end of the audit period can be a powerful incentive.

It is not possible to guarantee ethical standards and independence through legislation. The public must rely on the high ethical standards of the accounting profession to ensure the independence of auditors. Nonetheless, a statutory role for the audit committee in considering whether or not to change auditors at the end of an auditor's appointment may be helpful. With a majority of outside directors and an ongoing

responsibility related to auditors, the audit committee may be well placed to advise the members, in a relatively objective fashion, as to whether the auditor should be changed or replaced.

It is proposed that the audit committee be required to report to members on the auditor's performance at the end of the auditor's term and be able to make a recommendation to the members.

This requirement would take effect at the first annual general meeting after the amendment is in force. No other transition provision is required.

Chapter 9 — Fundamental Changes

Amalgamations

Sections 271 to 275 of the current act stipulate how two or more companies can amalgamate and continue as one company. Companies wishing to amalgamate must receive approval from the Registrar for the proposed memorandum of articles, obtain court approval and have the appropriate consent of the members of all companies.

The procedures in the current act for obtaining an amalgamation are cumbersome and difficult to work with, especially when compared with the corresponding provisions in other business corporation acts. Obtaining approval from the court and from the Registrar does not significantly contribute to the protection of members or creditors. It is unusual for either the court or the Registrar to disapprove of a proposed amalgamation. The current act treats all types of amalgamations as requiring the same amount of regulation, even amalgamations between related entities, and is unnecessarily restrictive as to the types of amalgamations that can take place. Furthermore, some questions have arisen as to what the legal effect of an amalgamation is. For example, *Crescent Leaseholds Ltd. v. Gerhard Horn Investments*, [1983] 1 WWR 305, 141 D.L.R. (3d) 679 (Sask. Q.B.) indicates that an amalgamation constitutes an assignment of a lease by operation of law.

Amalgamations require safeguards to ensure that members with minority interests and creditors are adequately protected. An amalgamation may take place between a financially strong company and a financially weak company, to the possible detriment of the creditors of the financially strong company. Experience has shown that amalgamations can be used to unfairly "squeeze out" some members unless there is appropriate protection (see Iacobucci, pages 442 to 443).

However, the protection afforded members with minority interests and creditors should be consistent with the principles of the *Company Act*. The act is a self-regulating statute. Neither the court nor the Registrar should be asked to protect members or creditors but, rather, these parties should be given the means to protect themselves. Rather than having the Registrar or the court approve amalgamations, the act should require members and creditors to receive notice of a proposed amalgamation and decide, for themselves, if it prejudices their interests. As well, the directors of a company should bear the

primary responsibility for ensuring that an amalgamation does not unfairly prejudice the rights of creditors and members. The act should not impose restrictions where it is clear that the interests of members or creditors are not threatened.

Most other jurisdictions require that either no creditor be prejudiced or that every creditor consent. This may give creditors unnecessary power. In practice, every amalgamation will involve one stronger and one weaker company and the creditors of the stronger company are arguably prejudiced, even if there is no material increase in the risk of a default. It seems reasonable that creditors only be able to object if a default is likely as a result of the amalgamation (i.e., if the amalgamated company has a substantially higher risk of defaulting).

It is proposed that the act adopt a scheme for regulating amalgamations which would

- require an amalgamation agreement setting out the same information as provided for in section 272(2)(a), (c), (d) and (e) of the current act;
- require that a director provide a statutory declaration that either no creditor would be materially prejudiced (ie., that the risk of creditors not being paid would not increase significantly), or that all major creditors would have been notified ("major creditor" would be defined with reference to the amount owing to them—perhaps $1,000);
- require a statutory declaration from a director or officer of each of the amalgamating companies that the director believes, on reasonable grounds, that the amalgamated company will be financially solvent;
- allow the directors of the amalgamating companies to apply to court for a finding that reasonable grounds exist for the director's belief that the amalgamated company will be solvent. Notice of this application would be served on creditors along with a notice of the proposed amalgamation;
- require members holding shares of each class of shares, or series of shares, if the series are affected differently, to approve the amalgamation, and the dissent rights currently found in section 231 would apply;

- allow the directors of either company to cancel a proposed amalgamation at any time before the Registrar issues a Certificate of Amalgamation;
- allow a wholly-owned subsidiary and its parent, or two or more companies wholly-owned by a person to amalgamate by passing a directors' resolution in place of a members' resolution. An amalgamation agreement would not be required;
- allow shares of an amalgamating company to be redeemable for the shares of a third company, as well as for the shares of the amalgamated company;
- clarify that an amalgamation is irrevocable and cannot be undone; and
- clarify the effect of an amalgamation to expressly refer to the continuation of liabilities and rights under civil, criminal, quasi-criminal, administrative and regulatory actions both by and against the amalgamating companies, and that an amalgamation does not constitute an assignment by operation of law.

No transition provision is required.

Attesting to the solvency of an amalgamated company and notifying the creditors of the company could be alternative methods of proceeding with the amalgamation. An argument could be made that only one or the other of these requirements is necessary. It has been suggested that if the amalgamated company is solvent, then the creditors need not be notified. Alternatively, if the creditors are notified of, and do not object to, the proposed amalgamation, the directors need not attest to the solvency of the resulting company.

Notwithstanding these arguments, the proposed amendments would require the directors of amalgamating companies to both attest to the solvency of the amalgamated companies and notify creditors of the amalgamation. Companies should not be allowed to amalgamate if the resulting company is insolvent. Such an amalgamation would be unfairly prejudicial to creditors, even if the creditors are notified. As well, creditors should always be made aware that a company is amalgamating. An amalgamation may alter substantially the long-term financial prospects of a debtor company. For these reasons, both solvency and notice to creditors is required of companies.

Sections 276 to 278 allow companies to make compromises and arrangements with their creditors or members. A compromise or arrangement can take place only if the court and a $^3/_4$ majority of creditors and members approve of it. The court can order a vote of the members to approve of the compromise or arrangement, and members must receive certain information about the compromise before they vote. Aside from having to approve, the court also has broad power to give effect to the compromise or arrangement if it involves an amalgamation or reconstruction of the company, or if part of the undertaking of the company is transferred.

Several different aspects of the compromise and arrangement sections have given rise to concerns. The scope of this procedure is unclear, and when a company may take advantage of these sections is uncertain.

The fundamental policy of the *Company Act* is to allow companies a great deal of flexibility to manage their affairs, while still protecting members and creditors. Attempting to balance these two objectives has resulted in some procedures which are relatively rigid and time-consuming. It may be impractical to comply with existing provisions where a compromise or an arrangement with creditors or members of the company is necessary for the company to survive.

On the other hand, the arrangement and compromise sections should not be used as a method of circumventing the procedures of the *Company Act*. The provisions of the *Company Act* which allow for fundamental changes embody policy choices between the rights of majority and minority interests. The court should not be asked to substitute its views on adequate procedural safeguards for the procedures set out in the act. Therefore, the arrangement and compromise sections should only be used when the procedures set out elsewhere in the act are impractical.

The current compromise and arrangement provisions set out in sections 276 to 278 could be used to avoid procedural safeguards. For example, it is possible that a compromise may be used to effect a takeover bid without the minority interests having the usual procedural and substantive safeguards. Although a company proceeding by way of arrangement to effect a takeover may adopt a number of the substantive safeguards applicable to takeover bids, there is no requirement that it must do so. Under section 278(2), the court is given

broad jurisdiction to deal with these issues only under a limited number of circumstances.

The court needs broad powers to ensure that the flexibility of the provisions is not abused. The court should be given a great deal of flexibility to deal with the variety of circumstances which may arise. The procedure must accommodate a number of different circumstances which are not amenable to the usual self-regulatory measures contained in the act. On the other hand, given the extraordinary scope of the procedure, and its ability to affect the position of members, the court should have the approval of the required majority of members and creditors before granting this remedy.

It is proposed that sections 276 and 277 be revised to:

- permit a compromise or arrangement only where it is impractical to use another provision in the act to effect a fundamental change to the company;
- require members holding shares of each affected class to approve the compromise or arrangement by the same percentage of votes as are required to pass a special resolution;
- clarify that court approval of a compromise or arrangement can include and replace the necessary approvals for any of the transactions currently set out in paragraphs 278(2)(c) to (i), as well as amalgamations and amendments to the memorandum and articles of a company. The court would be able to exercise broad power whenever the company has obtained the necessary approval from members, creditors and the other relevant parties. The pre-conditions to the jurisdiction of the court contained in paragraphs 278(2)(b) and (c) would be removed; and
- provide members of the company who have opposed the arrangements with a right of dissent under section 231 of the current act.

No transition provision is required.

Division 1 of Part 9 of the current act deals with the cancellation of companies. A company may be dissolved by the Registrar for failing to comply with the technical requirements of the act. Alternatively, a company may be dissolved voluntarily if an affidavit is sent to the Registrar stating that the company has no liabilities, it has disposed of its assets and the members have passed an appropriate ordinary resolution.

The provisions dealing with the dissolution of companies are unsatisfactory in a number of ways. The voluntary dissolution provisions are too rigid. A company cannot voluntarily seek to be dissolved if it has any liabilities, even if all its debts are fully assumed by another party. Furthermore, the effect of an involuntary dissolution on the property and rights of the company is unclear. No provisions exist for the personal property owned by the company at the time of dissolution, and the provisions regarding escheat of real property are cumbersome and uncertain where the company is not restored within one year.

It is proposed that

- in addition to the existing provisions, voluntary dissolutions be allowed where a director provides a statutory declaration to the Registrar that the company has adequately provided for the payment and discharge of all its debts and liabilities;

- the effect of a dissolution be clarified so that, with the exception of proposal 3 below, the company would cease to exist for all purposes after it is stricken from the Register;

- a company would be deemed to exist for the purposes of continuing litigation already begun against the company, even after being stricken from the Register of Companies. Provisions would be made for service of documents and for the satisfaction of judgments from the property of the company that was dissolved; and

- all property belonging to the company at the time of dissolution would vest in the Crown. Upon restoration, any remaining property would be returned to the company, less the costs of maintaining or disposing of the property.

No transition provision is required.

Restoration

Division 2 of Part 9 of the current act deals with the restoration of companies. A company may be restored by application to the court by certain interested parties. The person applying for the restoration must publish a notification for the application and obtain the consent of the Registrar and, where relevant, the Securities Commission.

The requirement for court approval to restore a company is a burden for both the members of the company and third parties who have a claim against the company. Requiring creditors to incur the expense of a court application in order to pursue their claim against a dissolved company is neither efficient nor fair. As creditors have not caused a company to be dissolved, they should not have to bear the expense of a court application to restore the company. Furthermore, court applications do not protect creditors, members or any other party. Restoring a company is an administrative matter that is best handled by the Registrar rather than the court.

It is proposed that restoration of a company would be accomplished by an application to the Registrar by any interested person.

No transition provision is required.

Chapter 10 — Extraprovincial Companies

Extraprovincial Corporate Names

The policy considerations of business names have been discussed in chapter 1.

The names of extraprovincial companies raise special issues. A company may have been incorporated in another jurisdiction and have goodwill attached to its company name. However, the name of the extraprovincial company may already be registered as a business name in British Columbia, or be ineligible for registration for some other reason. Under the current act, the extraprovincial company would be forced to either change its name, or form a subsidiary in British Columbia with a different name to do business in the province.

The names of extraprovincial companies, as with other business names, must be regulated. Regulation is needed to protect the public from confusing or misleading names. As a secondary purpose, regulation should provide some protection for property rights in a business name. The regulation of names of extraprovincial companies should achieve these objectives without imposing inordinate costs on the extraprovincial company.

It is proposed that all extraprovincial companies be allowed to register in British Columbia under their existing name, even if the name would be ineligible. If the extraprovincial company's name is ineligible under the proposed *Business Name Act*, then the extraprovincial company would have to carry on business under a pseudonym. The pseudonym would be registered and protected under the *Business Name Act*.

No transition provision is proposed. Extraprovincial companies currently operating in British Columbia through subsidiaries would be free to restructure their operations to take advantage of this provision at their discretion.

Disabilities and Penalties

Extraprovincial companies face fines and disabilities if they are carrying on business in this province without being registered. An extraprovincial company that does not register faces a fine of up to $50 per day, and, except for federal corporations, is unable to acquire or hold land or maintain an action in this province. As well, any person who acts as an agent for an unregistered extraprovincial company is liable to a fine of up

to $50 per day, and is personally liable for the debts and obligations incurred by that person as agent.

Not allowing extraprovincial companies to maintain actions or hold land unless they are registered has little practical benefit. Extraprovincial companies should register so that the public can identify them and obtain relevant information. However, the fine is likely to be sufficient incentive to register in this province. No extraprovincial company is likely to deliberately neglect to register. The inability to maintain an action or hold land causes complications for both the company and third parties, and is a trap for the unwary.

It is proposed that the inability of unregistered extraprovincial companies to maintain actions or hold land be eliminated, and that the personal liability of the agent be abolished. Instead, the Registrar and any interested party would be able to apply to the court for an injunction preventing the company from doing business until it has registered.

No transition provision is required.

Chapter 11 — Technological Innovations

Remote Registration

As one of the primary objects of the *Company Act* is to ensure appropriate disclosure, the act is largely concerned with the filing and disclosure of information. British Columbia companies should be able to meet the requirements of the act as efficiently as possible. In order to do so, they should be able to use the data storage and transmission technology developed since the last major revision of the *Company Act*.

The proposals set out in chapter 2 set out information registrants must file with the Corporate Registry to incorporate a company.

It is proposed that registrants be permitted to file this information directly on to the data bank of the Corporate Registry using their own off-site computer terminals. Other required filings (e.g., annual reports, notices of change of directors or registered office) could also be done electronically. Parties wishing to incorporate a company or file information using conventional paper forms would still be allowed to do so.

No transition provision is required but this change can only take effect after the necessary systems and administrative changes have been implemented.

This proposal would allow instantaneous incorporation of numbered companies, or companies with names that have been approved and reserved. The result would be that all information filed in the registry would be available for searching electronically as well.

Book-Based Securities

Under Part 3, Division 1 of the current act, every member is entitled to a share certificate. A signed share certificate is proof (in the absence of evidence to the contrary) of the title of the member to the shares. If the share is transferred, the company must record the transfer in a register of transfer.

The requirement that shares be certificated is cumbersome and expensive. Paper share certificates can be lost or destroyed and handling paper certificates for large share issues can be a burden. These problems are exacerbated if shares are negotiable as proposed in chapter 5. These provisions are not

consistent with other Canadian jurisdictions which allow shares to be transferred through the records of clearing agencies or with the PPSA, which allows uncertificated securities to be used as collateral.

It is proposed that the issue of share certificates be optional, provided that uncertificated shares are registered in the name of a clearing agency. It would be clarified that transfers of uncertificated shares and shares that are certificated but in bearer form and in the custody of a clearing agency, could be accomplished through an appropriate entry in the records of the clearing agency. The clearing agency would have to issue a receipt if requested to do so by a purchaser.

No transition provision is required.

Facsimile Transmissions

Section 186 deems any notice, statement or report that has been mailed to have been received the day following mailing, or a longer period of time set out in the articles.

Delivering messages by facsimile has become common, and the act should deal with service or delivery of documents effected by this means.

It is proposed that facsimile transmissions sent to a company that has a facsimile number be deemed to have been received at the time of transmission.

No transition provision is required except to ensure that this change does not call into question facsimile transmissions made before the change comes into force.

Appendix "A"

Division X — Indemnification of Directors and Payment of Expenses

Interpretation and Application

1 (1) In this Division

"eligible party", in relation to a company, means an individual who:

(a) is a director, former director, officer or former officer of the company,

(b) is a director, former director, officer or former officer of a corporation who acts or acted as such at the request of the company, or

(c) is a director, former director, officer or former officer of a corporation with which the company is, or was, affiliated,

[and includes the heirs and personal or other legal representatives of the individual to whom the context can apply according to law.]

"expenses" include costs, charges and expenses (including, legal and other fees), but does not include judgements, penalties, fines or amounts paid in settlement of a proceeding;

"proceeding" includes any civil, criminal, administrative, regulatory or investigative action or proceeding, whether threatened, pending or completed.

(2) [This Division only applies to and in respect of the indemnification or payment of expenses to an eligible party or his heirs and personal or other legal representatives.]

(3) Sections 126 and 127(1)(c) do not apply to an indemnification or payment of expenses made [permitted] [authorized] under this Division.

Indemnification and Payment of Expenses Permitted

2 Subject to section 5, and unless the articles or memorandum otherwise provide, if authorized by the directors of the company [by resolution of its directors] or by ordinary resolution, a company may

(a) indemnify an eligible party [and his heirs and personal or other legal representatives] against [liability to pay] all judgements, penalties, fines and amounts paid in settlement, and

(b) upon final disposition of the proceeding, pay the expenses actually and reasonably incurred by an eligible party [or his heirs and personal or other legal representatives]

in respect of any proceeding in which the eligible party is implicated or to which the eligible party is made a party by reason of being or having been a director or officer of the company or a corporation.

Mandatory Payment of Expenses

3 Subject to section 5 and unless the articles or memorandum otherwise provide, upon the final disposition of a proceeding

(a) in which an eligible party [or his heirs and personal or other legal representatives] are implicated, other than as a complainant, or

(b) to which the eligible party [or his heirs and personal or other legal representatives] are made a party

by reason of the eligible party being or having been a director or officer of the company or a corporation, a company shall pay the expenses actually and reasonably incurred by the eligible party [or his heirs and personal or other legal representatives] in respect of the proceeding and for which he has not been reimbursed, if the eligible party [or his heirs and personal or other legal representatives] are

(c) wholly successful, on the merits or otherwise, in the outcome of the proceeding, or

(d) substantially successful on the merits in the outcome of the proceeding.

Authority to Advance Expenses

4 Unless the articles or memorandum otherwise provide, if authorized by the directors of the company [by resolution of its directors] or by ordinary resolution, a company may pay, as they are incurred in advance of the final disposition of the proceeding, the expenses actually and reasonably incurred by an eligible party [or his heirs and personal or other legal representatives] in respect any proceeding

(a) in which the eligible party [or his heirs and personal or other legal representatives] are implicated, or

(b) to which the eligible party [or his heirs and personal or other legal representatives] are made a party

by reason of the eligible party being or having been a director or officer of the company or a corporation, but only if the company first receives from the eligible party [or his heirs and personal or other legal representatives], a written undertaking to repay the amounts advanced if it is ultimately determined that indemnification or payment of expenses is prohibited by section 5 [that there is no entitlement to payment by reason of section 5].

Indemnification Prohibited

5 A company shall not indemnify an eligible party [or his heirs and personal or other legal representatives] under section 2 or pay the expenses of an eligible party [or his heirs and personal or other legal representatives] under sections 2 or 3 if

(a) the eligible party did not act honestly and in good faith with a view to the best interests of the company or corporation of which he is or was a director or officer,

(b) in the case of a proceeding other than a civil proceeding, the eligible party did not have reasonable grounds for believing that his conduct was lawful, and

(c) in respect of any proceeding against the eligible party [or his heirs and personal or other legal representatives] by or on behalf of the company or corporation of which he is or was a director or officer, the approval of the court has not first been obtained.

Agreements to indemnify

6 (1) Nothing in this Division precludes a company, whether before or after the commencement of a proceeding, from entering into a written agreement with a person [an eligible party] under which the company undertakes to indemnify and pay or advance the expenses actually and reasonably incurred by that person by reason of that person being or having been a director or officer of the company or a corporation.

(2) Every agreement referred to in subsection (1) is subject to this Division.

Court Ordered Indemnification

7 Notwithstanding any other provision of this Division and whether or not payment of expenses or indemnification has been sought, authorized or declined under this Division, on application by the company or an eligible party [or his heirs and personal or other legal representatives], the court may

(a) order a company to indemnify an eligible party [or his heirs and personal or other legal representatives] against any liability incurred by the eligible party [or his heirs and personal or other legal representatives] in respect of a proceeding,

(b) order payment by a company of the expenses incurred by an eligible party [or his heirs and personal or other legal representatives] in respect of a proceeding,

(c) order the enforcement of, or any payment under, an agreement of indemnification entered into by the company,

(d) order a company to pay the expenses actually and reasonably incurred by any person in obtaining an order under this section, or

(e) make any further or additional order it considers appropriate.

Insurance

8 A company may purchase and maintain insurance for the benefit of an eligible party [or his heirs and personal or other legal representatives] against any liability incurred by reason of the eligible party being or having been a director or officer of the company or a corporation.